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The pandemic threat

How scared should you be?

Print edition May 2nd 2009

The pandemic threat
It's deadly serious; so even if the current threat fades, the world needs to be better armed: leader

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Politics this week

Apr 30th 2009
From The Economist print edition

Reuters

Swine flu spread from Mexico, where it was reported to have claimed more than 170 lives, to at least ten other countries, prompting the World Health Organisation to declare a pandemic imminent. Mexican authorities ordered a halt to all non-essential activities for five days from May 1st. Some airlines halted flights to the country and some governments urged their citizens not to travel to it. See article

The incumbent president, Rafael Correa, won **Ecuador's** presidential election, with 52% of the vote compared with 28% for Lucio Gutiérrez, his nearest rival. His party also won a legislative majority. Mr Correa has hugely increased social spending but now faces lower oil prices and falling remittances from some 2m Ecuadoreans abroad.

Colombia's intelligence agency sacked 11 of its officials over their alleged involvement in illegal eavesdropping on judges, journalists and politicians, bringing to 33 the number fired because of the scandal since February.

Happy 100 days, Mr President

As **Barack Obama** marked 100 days in the White House, his job approval ratings, at 68%, were higher than for any other recent president at this stage. The latest *New York Times*/CBS poll also found that 72% of Americans were optimistic about the next four years with Mr Obama as president. See article

Mr Obama got a further boost when **Senator Arlen Specter** of Pennsylvania announced that he would switch parties and run for re-election as a Democrat in 2010. Assuming he wins, which is likely, his defection will increase to 59 the number of seats the Democrats control in the Senate. They could reach the magic filibuster-proof 60 if Al Franken is ever officially declared the winner of last November's Minnesota race. See article

The **Supreme Court** ruled that the government could threaten broadcasters with fines over even a single swear-word on live television. It refused to say whether a new ruling by the Federal Communications Commission, that "fleeting expletives" are indecent, was an affront to the constitutional guarantee of free speech.

Arguments continued over the Obama administration's release of classified memos detailing **"enhanced interrogation" techniques**. Last year's Republican presidential candidate, John McCain, said he did not think it necessary to release further documents purporting to show the effectiveness of such methods in gleaning information.

The White House apologised after a presidential jet accompanied by a fighter aircraft flew low and close to tall buildings, causing consternation in lower **Manhattan**, with some workers fleeing their offices. The jet was being filmed for a promotional video.

Form an orderly queue, please

EPA

The Social Democrats triumphed in **Iceland's** election, so Johanna Sigurdardottir will continue as prime minister. She promised to seek to join the European Union quickly, but her coalition partner is against. There may be a referendum before any application is made. See article

Albania formally applied to join the European Union too, though it may take

years to get in. Elsewhere in the western Balkans, applications from Macedonia and Montenegro are pending, and Croatia's membership talks have stalled.

The candidate of Vladimir Putin's ruling party easily won election as mayor of Sochi, in **Russia**. The election was closely watched because the Kremlin promised it would be fair, and because Sochi is holding the 2014 winter Olympics. Opponents said it was rigged.

The European Court of Justice upheld a decision by a court in **Cyprus** to allow a Greek-Cypriot who fled after the Turkish occupation of northern Cyprus in 1974 to reclaim land that was later sold to a British couple. Turkish-Cypriots said the decision would harden opposition to plans to reunite the island.

Nine Turkish soldiers were killed in a landmine explosion in south-eastern **Turkey**. The army blamed Kurdish terrorists from the PKK rebel group.

So near, so far

South Africa's ruling African National Congress won just under 66% of the vote in a general election. When the new parliament meets on May 6th, it is sure to elect the ANC's leader, Jacob Zuma, as the country's president. But by narrowly failing to win two-thirds of the seats, it will not be able on its own to change the constitution. See article

Three car bombs exploded in quick succession in **Iraq's** capital, Baghdad, on April 29th, killing at least 41 people and wounding a further 70 or so.

The **Sudanese** government sentenced 82 men to death for their alleged involvement in an attack a year ago on the capital, Khartoum, by the Justice and Equality Movement, a Darfur rebel group. Human-rights organisations argue that their trials were grossly unfair.

Back to battle

After fierce criticism from senior American officials of its "abdication" to the Taliban in parts of the country, **Pakistan's** army attacked militants in the North-West Frontier Province (NWFP). It accused the Taliban of breaking an agreement reached in February under which *sharia* law would be adopted in large parts of NWFP's Malakand division in return for their laying down their arms. See article

AP

Sri Lanka's army defied calls from foreign governments for a humanitarian pause in its campaign against Tamil Tiger rebels. It dismissed as a ploy a unilateral ceasefire called by the rebel Tamil Tigers, and continued its advance into the last few miles of Tiger-controlled territory. The United Nations estimated that 50,000 civilians remained trapped with the Tigers. See article

North Korea, rejecting appeals to rejoin six-party talks on its nuclear programme, said that it was once again reprocessing spent fuel rods at its nuclear plant at Yongbyon. It threatened to carry out nuclear and missile tests unless the United Nations apologised for the Security Council's criticism of its recent rocket launch.

Taiwan said it would attend the UN's World Health Assembly in May, signalling China's agreement to its participation for the first time since it lost its UN seat to China in 1971. The breakthrough followed talks in China at which further steps were taken to promote commercial ties. See article

Business this week

Apr 30th 2009
From The Economist print edition

Shareholders at **Bank of America** chose Walter Massey, a veteran member of its board, to be its new chairman. He will replace Kenneth Lewis, who stays on as president and chief executive. Daniel Bouton, the chairman of **Société Générale**, France's third-largest bank, announced on April 29th that he would step down. See article

BP's first-quarter net income of $2.56 billion was 64% lower than a year earlier. Like other oil companies, it has been hit by the steep decline in oil prices, which have fallen by more than $100 a barrel from their peak in July last year.

Another negative reading

American GDP fell at an annualised rate of 6.1% in the first quarter of this year. The world's largest economy has now contracted for three three-month periods in a row. The fall was bigger than most had expected, and puts the cumulative shrinkage so far during this recession on a par with those in the downturns of 1973-75 and 1981-82, the worst of the post-war period. Much of the fall was due to businesses slashing inventories to cope with drops in sales. Consumer spending did rise, but much of this was offset by a sickening plunge in business investment, which fell at a 38% annual rate, the steepest on record. See article

The pace of decline in **American house prices** slowed slightly in February, according to Standard & Poor's, a rating agency. Its S&P/Case-Shiller 20-city composite index of prices of existing single-family homes fell by 18.6% in February, compared with January's 19% drop. But house prices still plunged by record rates in February in ten of the 20 cities covered by the index.

Computer-maker **Sun Microsystems** announced revenues of $2.61 billion for the three months to March, 20% lower than a year before. The company's net loss for the quarter was $201m, up from $34m a year earlier. Profits were down 16% on a year earlier at **SAP**, a German business-software company. Its net profit for the quarter was €204m.

Into the red

Several **car companies** reported grim quarterly earnings numbers. Luxury carmaker **Daimler** reported a net loss of €1.3 billion ($ 1.7 billion), down from a net profit of €1.3 billion a year earlier. The story was similar at **Honda**, which made a quarterly net loss of ¥186.1 billion ($1.9 billion) compared with a net profit of ¥25.4 billion a year ago. **Volvo,** the world's second-largest manufacturer of trucks, saw a net loss of Skr4.2 billion ($502m), compared with a profit of an almost identical amount a year earlier. And **Ford**, which made a profit of $70m in the first quarter of 2008, ended the first quarter of 2009 with a loss of $1.4 billion. See article

Pharmaceuticals companies, at least, are still making profits. **Pfizer's** first-quarter profit of $2.73 billion was only slightly lower than last year's figure of $2.78 billion. The giant drugmaker has taken a hit from the stronger dollar, a particular concern for the company because 54% of its sales come from foreign markets. But profits at **Bristol-Myers Squibb** increased, to $921m from $891m a year earlier.

Profits at **Bharti Airtel**, India's largest provider of mobile-phone services, rose by 21% in the first three months of this year. In that period 8.3m more people signed up for its services, bringing the total to 94m. The total number of mobile-phone users in India reached 392m by the end of March, making the country the world's second-largest market after China.

EDF, a French electricity company, and a consortium of **RWE** and **E.ON**, two German firms, won sites on which to build new nuclear-power plants in Britain in an auction that raised £387m ($571m) for the government. EDF won one site at Bradwell, in Essex. RWE and E.ON won sites at Oldbury in Gloucestershire and Wylfa in Wales. A full list of up to 11 sites will be finalised later in the year.

Deutsche Bank announced strong first-quarter results, reporting a net profit of €1.2 billion, compared with a net loss of €131m a year earlier. It also said on April 27th that its chief, Josef Ackermann, would stay on for another three years after his present term runs out in May next year.

A shrinking portfolio

Falling advertising revenues claimed another victim, as **Condé Nast**, a media conglomerate, announced that it was pulling the plug on *Portfolio*, the business magazine it launched two years ago. *Portfolio's* ad revenues fell by 49% in the first three months of this year, compared with a 20% drop for the magazine industry as a whole, according to the Publishers Information Bureau, a trade group.

The European Commission proposed stricter regulation for **hedge funds** and private-equity funds with more than €100m under management. Fund managers warned of job losses and said the industry would be crippled.

KAL's cartoon

Apr 30th 2009
From The Economist print edition

Illustration by KAL

Pandemics

The pandemic threat

Apr 30th 2009
From The Economist print edition

It's deadly serious; so even if the current threat fades, the world needs to be better armed

Illustration by KAL

IT IS said that no battle-plan survives contact with the enemy. This was certainly true of the plan drawn up over the past few years to combat an influenza pandemic. The generals of global health assumed that the enemy would be avian flu, probably passed from hens to humans, and that it would strike first in southern China or South-East Asia. In fact, the flu started in an unknown pig, and the attack came in Mexico, not Asia.

The hens, though, deserve some credit. The world has not had a pandemic (a global epidemic) of influenza since 1968. Four decades are long enough to forget that something is dangerous, and people might have done so had they not spent the past ten years considering the possibility that a form of bird flu which emerged in Hong Kong in 1997 might be one mutation away from going worldwide.

The new epidemic (see article) was raised on April 29th to just one notch below the level of a certified pandemic by the World Health Organisation. In an effort to halt the spread of the disease, Mexico's president, Felipe Calderón, has announced that non-essential services should close down between May 1st and 5th, and people should stay at home. Part of the reason for worry is that, unlike ordinary flu, which mostly carries off the old, the victims of this disease are mostly young and otherwise healthy.

Still, this epidemic has not actually killed many people yet. That there have been a mere handful of confirmed deaths is probably the result of a lack of proper tests. But even if all the possibles are counted in, a couple of hundred fatalities cannot compare with the 30,000 deaths caused in America each year by seasonal influenza. So how scared should we be?

Damned if you do, damned if you don't

As far as this epidemic is concerned, it's too early to tell. One unknown is how widespread the virus is in Mexico. If it is ubiquitous, and had not been noticed earlier because it emerged during the normal flu season, then this epidemic may turn out to be insignificant, at least to start with. No flu death is welcome, but in this case the new disease might not increase the immediate burden greatly. But if the new strain is relatively rare, or what is being seen now is a more dangerous mutation of what had once been a mild virus, then the proportion of infected people dying may already be high. The death-toll, then, will rise sharply as the disease spreads.

Either way, the authorities were right to hit red alert. Influenza pandemics seem to strike every few decades and to kill by the million—at least 1m in 1968; perhaps 100m in the "Spanish" flu of 1918-19. And even those that start mild can turn dangerous. That is because new viral diseases generally happen when a virus mutates in a way that allows it to jump species, and then continues to evolve to exploit its new host. If that evolution makes the virus more virulent, so much the worse for the host. HIV, the AIDS-causing virus, lived happily and benignly in chimpanzees before it became a scourge of people. In Mexico, the early indications are that two pig viruses that can infect people but rarely pass from person to person recombined with each other to create a virus which does so easily.

Changes in virulence have certainly happened before in influenza epidemics, which have struck in successive waves of different severity. The message is that it makes sense to put money and effort into containing the new infection even if it does turn out to be relatively harmless today. The more people who have the virus, the more virus particles there are for that one, fatal mutation to appear in.

Resistance is another reason to try to contain an epidemic early. New antiviral drugs that were not around during past epidemics seem to be effective against the current outbreak. But natural selection is a powerful force, and if the spread of the disease means they have to be used widely, a resistant strain of the virus could easily evolve.

Don't wait till winter

Now is the time to prepare for the worst. Flu—including pandemic flu—tends to be seasonal. The infection will probably tail off in the north over the next few months and head south as winter gets a grip on the Earth's less populated hemisphere. It would make sense, therefore, to put the antiviral factories on overtime immediately, and try to develop, manufacture and distribute a vaccine.

Crash vaccine programmes pose their own risks. In 1976 flu vaccines killed a lot of people in America. But the growth of biotechnology means there are new ways of making vaccines and new types of vaccine to make. Mostly, these have been aimed at the threat of bird flu. But laboratories will already be clearing the decks to receive their first samples of the new swine flu, and getting to work on countermeasures.

And there is one further lesson. The system of checking for new diseases also needs to be improved. Partly because everyone was looking at Asia, no one was concentrating on Mexico. But as genetic sequencing becomes cheap and routine, it ought to be possible to pick dangerous mutations up quickly.

That would mean sending samples from doctors' surgeries to a central laboratory dedicated to sequencing, even when nothing strange was suspected. And that would require organisation and money. Not every person with a sniffle need be tested—only a small, representative sample. But if this had happened in Mexico over the past few months, the generals of global health would have seen that something was coming down from the hills and they could have mobilised sooner.

Active caution, then, is what is called for. The world's policymakers, most of whom live in the northern hemisphere, should not be fooled into thinking the new virus is going away for long, even if it declines over the next few months. Instead, as in any phoney war, they should use the time they have been granted to reinforce the world's defences by stocking up with antiviral medicine and making vaccines. They should also remember that, even if this flu turns out to be less frightening than feared, it is only a matter of time before a deadlier one comes along. A drill today will help to spare millions of lives in the future.

Economist.com OPINION LEADERS

Italy

Regrettable Berlusconi

Apr 30th 2009
From The Economist print edition

What a pity Italy's prime minister does not use his political muscle to reform his country

EPA

THIS newspaper has never thought much of Italy's prime minister. In 1994, during Silvio Berlusconi's first brief stint in the job, we called on him to resign. In 2001, before his second, we declared that his frequent brushes with the law and the conflict of interest inherent in his ownership of almost all the country's commercial television channels made him unfit to lead Italy (see article). A year ago, as he campaigned for the job of prime minister for a third time, we advised Italian voters to back his main opponent, Walter Veltroni (see article). Yet Mr Berlusconi has gone from strength to strength, even as his country has not.

For the leader of a country in a dire recession, his popularity is startlingly high. Enough Italians appear to forgive, or at least overlook, his innumerable gaffes—whether on television talk-shows or at international summits. He has won plaudits for his energetic response to the earthquake in L'Aquila. His political grip is secure. On the right he is unchallenged, even though he will turn 73 in September. The centre-left opposition, which recently dumped Mr Veltroni, is making little headway. In short, Mr Berlusconi is more dominant than ever—indeed, disturbingly so (see article).

It is not just a question of worrying about one man's power. Italy's problems are also as daunting as ever. In a global crisis, its performance looks better, but only because other economies have fallen so fast. The IMF forecasts that GDP will shrink by 4.4% this year, less than in Germany but more than in Britain, France and Spain. Unemployment is still under 7%, but that partly reflects dreadful productivity, measured in output per person. Indeed, Italy is the only G7 rich country in which productivity has fallen in the past ten years. With real wages rising despite this, Italy is becoming less and less able to compete with other euro-area countries such as Germany.

Italy desperately needs more reform. According to the OECD, its product market is the most highly regulated in Europe. It has one of the worst records of implementing EU internal-market directives. Its labour market is sharply divided between protected, well-paid insiders and unprotected, temporary workers—one reason why youth unemployment is high. Educational standards are poor, research spending is low. The public finances remain a mess: although the budget deficit, at around 5% of GDP, is no longer exceptional, the public debt will rise above 120% of GDP in the next two years.

A cavaliere's chance

This should be a golden opportunity for Mr Berlusconi. He surely cannot hope to become prime minister again in 2013. If he ever wants to reform Italy, now is the time. His government, which marks its first anniversary next week, has done some good things. It helped to fix the Naples rubbish crisis. It is shaking up public administration and the education system. It has even begun judicial reform, though here more than elsewhere the prime minister's motives are suspect. Yet the overall record suggests that Mr Berlusconi is neither a liberal reformer nor a genuine believer in competition, but a businessman who went into politics principally to protect his own affairs, not to advance the cause of Italian business in general.

Italy has huge potential. Public debt may be high, but private debt is low. The banks are exposed to eastern Europe, but so far none has had to be rescued. The turnaround of Fiat, which may now take over Chrysler, has been remarkable. The small exporting firms in the north have proved admirably nimble. If Mr Berlusconi would only do more to loosen the shackles on the country's entrepreneurs, the results could be sensational. But Italians will probably have to wait till they see the back of him before that happens.

South Africa

It needs an opposition

Apr 30th 2009
From The Economist print edition

Jacob Zuma has proved he can win votes. But can he run a serious democracy?

Reuters

YOU have to hand it to the irrepressible Jacob Zuma. Four years ago he was sacked as South Africa's vice-president in humiliating circumstances after his financial adviser was sent to prison for soliciting bribes on his behalf. A year later he was tried for raping a family friend nearly half his age whom he knew to be HIV-positive. Though acquitted, he has been persistently ridiculed both for his apparent ignorance about the AIDS plague that has devastated his country and for his behaviour. He was endlessly undermined by Thabo Mbeki, South Africa's president for most of the post-apartheid era, who sensed a populist rival. The ruling African National Congress (ANC) recently suffered a bad split, with a chunk breaking off to form a black-led opposition that seemed determined to do Mr Zuma down. This former herd-boy has been sneered at by many of his more lettered compatriots, black as well as white, for his lack of sophistication. Yet Mr Zuma has the last laugh: following the ANC's election victory, Parliament will shortly make him president of Africa's most dynamic country.

When it came to the vote, in an admirably free and entirely fair election, Mr Zuma's party achieved the sort of landslide—66% of votes cast on a turnout of 77%—that most democratically elected leaders elsewhere in the world, not to mention the rest of Africa, can only dream of. At a time of growing economic anxiety, it matches the ANC's score when Nelson Mandela stepped down in his heyday in 1999. Mr Zuma is not just a gritty survivor. He is a remarkable communicator who can charm people of quite different stripes into believing he is on their side. At least in electoral terms, he is a stellar politician.

Will he now confound the doubters? The worst feature of the ANC's recent rule has been corruption in its ranks and the party's growing tendency to conflate its own interests with those of the state. Mr Zuma has not been immune to this tendency. He has hinted at curbing the independence of the judiciary. Though never convicted in court, he has hardly been viewed as a paragon of probity. Too many of his ANC friends have rated loyalty to their party—and to dodgy party pals—above their duty to the poor masses who elected them.

Mr Zuma's choice of cabinet will offer clues. There are worries in business circles that he may drop or lose the country's durable and respected finance minister, Trevor Manuel. It would be a good sign if he were retained. Better still if Mr Zuma found ways of demonstrating that South Africa's financial reputation does not rest on the shoulders of one man.

On paper, it looks good that the ANC failed to win more than two-thirds of the seats in Parliament, which would have let it alter the constitution and behave as if South Africa were a one-party state in the making. But that danger persists: Mr Zuma could yet cajole a bunch of parliamentarians from minnow

parties, elected by proportional representation, into voting for any change the ANC wants.

What’s the alternative?

Mr Zuma’s government could do with a strong opposition to help keep it honest. The liberal Democratic Alliance, led by a courageous former anti-apartheid campaigner, Helen Zille, who is white, did better than expected. Its vote rose from 12% to nearly 17%, and it won the Western Cape province, which includes the city of Cape Town, outright. The Alliance failed to make inroads into the black vote, getting most of its support from whites, coloureds (people of mixed race) and Indians, yet it offers a sharp critique of the ANC and airs liberal social and economic policies. The new breakaway party from the ANC, the Congress of the People, known as Cope, won barely 7% of the vote.

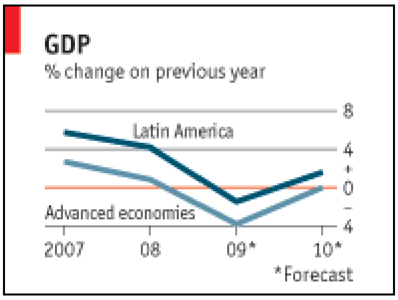
It is unclear whether the Alliance and Cope have enough in common to join up. A sturdier opposition may one day emerge on the left. But South Africa needs to foster pluralism to ensure that independent institutions and voices endure in the face of the ANC’s yen for untrammelled power. Mr Zuma may seem a national unifier. But his record suggests he will be tempted to cut corners. If he uses his populist charm to become just another African autocrat, it will be a tragedy.

Latin America's economies

That fragile thing: a good reputation

Apr 30th 2009
From The Economist print edition

A reformed region cannot escape recession but it can mitigate its impact



FOR much of the past two centuries Latin America has been a byword for the profligate squandering of economic promise and for financial crisis. So ingrained is this reputation that when Chile's president recently met Britain's prime minister and boasted of her government's foresight in saving some of its windfall revenues during the boom years, George Osborne, the shadow chancellor of the exchequer, sneered: "Gordon Brown is getting lessons from the Latin Americans about sound public finances. You couldn't make it up."

Happily, Mr Osborne's view of Latin America is outdated, or at least it now applies in only a few places. Over the past decade, most of the bigger countries in the region have greatly improved their economic policies and the government institutions that implement them. That is the main reason why Latin America was until recently a spectator in the world financial crisis. Its banks are generally conservative and well-regulated. Many countries eschewed their past habit of abusing a boom to borrow. Public finances were mostly in balance, public debt fell and the region ran a current-account surplus. Indeed Chile is one of the world's best-managed economies by almost any yardstick, but Mexico, Brazil, Colombia, Peru and Uruguay are not all that far behind.

Sadly none of this has shielded the region from the world recession (see article). Most forecasters predict that Latin America's output will contract this year and recover only modestly next year, so income per head will shrink. Some countries are doing worse than others. Even before the flu outbreak, Mexico had been especially hard hit, because its economy is so closely tied to that of the United States. Brazil is better placed. Argentina, Venezuela and Ecuador have spurned the prudence of their neighbours and antagonised investors. Only the uncertain prospect of Chinese aid stands between these three countries and possible financial crisis next year.

Yet overall, in contrast to its past recessions, Latin America is doing no worse than the world as a whole. In other words, it is not adding to its troubles with internal weaknesses. What's more, its governments have been able to cushion the blow with counter-cyclical policies of the kind that the rich world has taken for granted since Keynes but which Latin America's habitual profligacy and lack of credibility denied it in the past. So instead of having to cut spending as tax revenues fall, this time many governments have been able to increase it. Their central banks have earned sufficient credentials as inflation fighters, and many have enough reserves, to cut interest rates without prompting a dangerous weakening of the currency.

Know your limits

Still, there are limits to what governments can do to mitigate the pain. While there's scope, by and large, for easing monetary policy, fiscal policy is more constrained. The IMF, the World Bank and the Inter-American Development Bank will plug much of the gap this year, but next year looks harder. Tax revenues will have fallen further and Latin American governments' dodgy past records may hamper their ability to raise money in debt markets that will be heavily oversubscribed.

The priority for those governments should be to maintain their hard-won reputation for financial stability. That will mean keeping a tight rein on budgets. Some of the social gains of recent years will inevitably be lost. But governments can help the poor by focusing spending on, for instance, preventing child malnutrition, discouraging pupils from dropping out of school and beefing up health services.

There is another, harder lesson. Latin America's recent growth owed much to the outside world, cheap

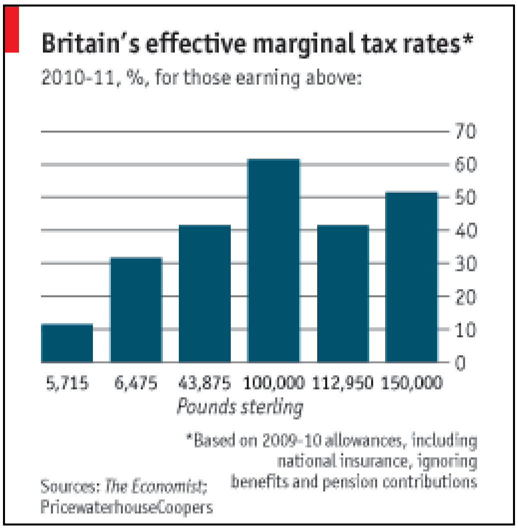
money and high commodity prices. With the world economy facing (at best) several sluggish years, the region will have to look closer to home for growth, by raising its productivity. That needs a huge effort not just to improve education, but also to implement long-postponed reforms of, for instance, labour markets. Such things are never easy in Latin America, where democratic politicians face voters who have to bear the world's widest inequalities of income. But if the region is to consolidate its still novel reputation for prudent progress and good management, they will have to be done.

Tax

A nasty Brown mess

Apr 30th 2009
From The Economist print edition

The politics behind Britain's tax changes are ugly. The economics are worse



JEAN-BAPTISTE COLBERT, Louis XIV's finance minister, famously said that the art of taxation was like plucking a goose; the aim was to get the most feathers with the least hissing. But tax policy should aim to do more than smother protest: it should also seek to raise the most money with the least distortion to economic activity.

By this measure, Britain's attempts to fill the fiscal gulf created by recession are a dismal failure and a lesson to cash-strapped governments everywhere. Take marginal income tax rates, announced in the British budget of April 22nd. Once national insurance is added in, effective marginal rates will climb from 31.5% to 41.5% through to 61.5% on those earning just over £100,000 ($147,000), thanks to the withdrawal of the personal tax allowance. After that, the rate will fall back to 41.5%, before rising again to 51.5% on incomes over £150,000.

The bizarre incentives of income tax are only the start. High earners also face the withdrawal of tax relief on their own pension contributions and a tax charge on the "benefit-in-kind" provided by employers' payments into their schemes. Depending on how much the employer contributes, this will push marginal rates well above 50%. It will also discriminate against employees in defined-contribution, or money-purchase, schemes where employers match what workers put in. But the effect is not uniform; the convoluted rules will mean some high earners will get more tax relief on their contributions than they did before. What a mess.

As recently as 2006, the government drove through a reform of the pensions rules that simplified a notoriously complex system. Employees could, in effect, make pensions contributions when they felt flush and still get tax relief. Those reforms were a much-needed incentive for employees to build up their pensions at a time when many employers were abdicating responsibility for providing a decent income in retirement. The new rules return pensions to the complexity of string theory.

The best tax systems combine low rates with minimal exemptions. Businesses and citizens should be making decisions based on their economic opportunities, not the advice of their accountants. But Gordon Brown is too clever by half. He introduced a sliding scale that made capital-gains tax highly complex, and then reversed himself, introducing a single rate of 18%. The effect was both to raise the tax rates for sellers of small businesses and to introduce a vast discrepancy between the tax rates on capital and income. An attempt to introduce a levy on foreign workers (known as non-doms) was botched, and may yet drive many high-earners out of the country.

These wheezes were designed chiefly with politics in mind: all those nasty plutocrats deserved a hammering. By putting economics second, Mr Brown has made it harder to balance the books. Waste and lower growth because of poor tax policy will only make the fiscal hole harder to fill. The new tax will do little to reduce Britain's budget deficit. On the government's own forecasts, which assume the wealthy will not change their behaviour, the assault on the rich will raise just £7 billion. With avoidance, the tax will raise still less.

Brown's goose cooked

Although higher taxes would be a mistake in a recession, they are inevitable when growth returns. The

rich should pay their share, but governments cannot repair their finances merely by plugging holes or using stealth taxes. The sums are too great. They will have to raise money from the majority of citizens and they should do so in a clear and open fashion.

The aim should be to reform and broaden the tax base. During the boom, the British government became too dependent on financial services, raking in money from income taxes on bonuses, capital-gains taxes on rising share prices or corporation taxes on bank profits. One reason its deficit has risen so quickly is that those revenues have evaporated. They may not return again for some time.

Governments will need new sources of revenue, just as value-added tax, introduced in Britain in the 1970s, became a counterpart to income tax. Carbon taxes are one possibility. The lingering tax privileges of residential property could also go. The need is for decisive action, rather than fiddling. Meanwhile, the Treasury says that it is still “consulting” on the new pension rules. It should consult the book of common sense.

On Iranian dissidents, the wealthy, Thailand, television, biofuels, Islam, Oakland's mayor, Placido Domingo

Apr 30th 2009
From The Economist print edition

A voice of dissent

SIR – Your article on the Iranian opposition group, the People's Mujahedeen of Iran (PMOI), ("Where will they all go?", April 11th) repeats untruths commonly voiced by the Iranian regime's Ministry of Intelligence and Security to demonise the Iranian resistance. After several investigations, our parliamentary committee has published literature showing the ministry recruits former PMOI volunteers to peddle disinformation about the resistance.

You say that the group is "widely described by independent observers as a cult" and is "reviled" by human-rights groups. In fact, the PMOI strives for a free Iran with UN-supervised elections to ensure democracy. Iraqi forces have besieged parts of Camp Ashraf, where 3,500 men and women belonging to the PMOI are living, cut off access to fuel and medicine, and prevented Iraqi doctors and relatives of PMOI members from visiting those inside. These actions began after Iran's supreme leader, Ali Khamenei, told Iraq's president, Jalal Talabani, that he expected Iraq's government to implement a "bilateral agreement" to expel the group.

PMOI members in Camp Ashraf are "protected persons" under the Fourth Geneva Convention and international law, which forbids their forced displacement, even within Iraq. The European Parliament has passed a resolution urging Iraq's government to treat Ashraf residents in accordance with these obligations. Instead of reminding readers of the humanitarian rights of those in the camp, you set the stage for a human catastrophe there.

Lord Corbett of Castle Vale
Lord Waddington
Lord Archer of Sandwell
Lord Fraser of Carmyllie
Lord Dholakia
David Jones MP
Henry Bellingham MP
Lady Gould of Potternewton
Lady Turner of Camden
Lord Taverne
Andrew Mackinlay MP
Lady Verma
Mike Hancock MP
Lady Dean of Thornton-le-Fylde
Lord Alton of Liverpool
David Amess MP
Rudi Vis MP
Brian Binley MP
David Drew MP
Lord King of West Bromwich
Mark Williams MP
Lord Inglewood
Lord Turnberg
Roger Gale MP
Lady Blood
John Leech MP
Lord Clarke of Hampstead
Lord Joffe
Ian Gibson MP
Bob Russell MP
Joe Benton MP

British Parliamentary Committee for Iran Freedom
London

Rich mix

SIR – In concluding that wealth "inequalities are likely to lessen now" because, among other reasons, "[the poor] will not be troubled by collapsing asset prices because they do not own assets" ("More or less equal?", April 4th), you fail to acknowledge the wisdom of that great champion of American free enterprise, Robert Heinlein: "People who go broke in a big way never miss any meals. It is the poor jerk who is shy a half slug who must tighten his belt". The poor will be more likely to have to forgo food, clothing, heating, health care, education and shelter, and will suffer greater damage to their health, children's future prospects and happiness.

The poor also depend much more on those items of spending likely to be counted no longer affordable: creches, benefits, public health initiatives, subsidised travel on public transport and so on. Just about everyone is suffering in the Great Recession. But we should not delude ourselves that it is as tough for the rich as for the poor.

Stephen Hill
London

SIR – Your leader misses a crucial point ("The rich under attack", April 4th). Finance capitalism has created a finance aristocracy totally separated from the commonweal, with no real customers and no social attachments to country or human being. The question one must ask, even as an ardent capitalist, is whether capitalism is master or slave to man. That a person can become indecently rich by providing neither service nor product instructs a world of onlookers to do likewise.

Chris Burns
Hanover, Pennsylvania

The following letters about the rich appear online only

SIR – Your high-gloss treatment of the havoc wrought by crony capitalism is well off the mark. You begin with a false premise, as the wealthy are not the target of vitriol per se. You compound that error by conflating the "rich" with "financiers", to the exclusion of corrupt "entrepreneurs" and various co-conspirators, and in so doing contaminate hard-earned wealth with that ill-gotten. The public's righteous anger is specific and directed at three groups.

First, it is levied at the parties who through stupidity and greed (and in some cases fraud) have wrecked our economy. They made huge losing bets with our retirement funds while conspiring to hide risk and falsify asset values. The absurd self-paid bonuses in the face of utter failure simply add mockery to the malice. Second, the bond raters, accountants, lawyers, regulators, lobbyists, and politicians who aided and abetted in this shell game. Third, the corporate executives and compensation committees who have completely disconnected performance from pay through the propagated "money for talent" myth. The anger is highly justified and will not be assuaged by your paper's ignoble apology for the perpetual greed machine.

Stephen Futterer
Chicago

SIR – I smiled and grimaced at your cover depicting a hyperbolic, French Revolution-like scene representing the mob attacking the rich, and the accompanying leader. I smiled because the leader, despite its title, contained one of the most rational but oh so gently-expressed critiques of the rich and of capitalism in the early 21st century that I have read, and the most far-fetched conclusions about how the rich might be attacked and suffer in the future. I grimaced because, even though you did not use the term "class warfare", you reinforced that ridiculous concept. The rich do not face the guillotine and I bet won't come close to falling below the inequality ratios of past decades. My gut feeling is that it is the poor, not the rich, who are suffering disproportionately and are truly under attack in these troubled times.

Harris Webster

Montpelier, Vermont

SIR – Delacroix's painting is commemorating the revolution in 1830 which toppled Charles X. The people took to the streets to protest censorship laws and defend freedom of speech. This is not about the rich versus the poor. At a time when dirigisme and state intervention is viewed as the solution to all our economic problems, I have been disappointed to see *The Economist* siding with an overwhelming anti-libertarian consensus.

Vincent Bourgeois
London

Thai stick

SIR – Banyan is wide of the mark with regard to Thailand (April 18th). By law, the Thai monarchy is not involved in politics and is non-partisan, and the king himself has taken care to exercise his duties and prerogatives within the bounds of the constitution. Meanwhile, he is closer to his people than many other monarchs have ever been. It is through his principled neutrality, integrity and hard work, rather than the constitutionally stated “inviolable position”, that he has earned moral authority as well as Thai people’s love and respect.

As for the current crisis, as events unfolded, Thailand’s government was able to restore law and order. Some injuries regrettably resulted as officers tried to stop the riots, but there were no deaths due to the government’s operations. Rather than being “unelected”, the government came to office in the same way as its two predecessors, which later lost their powers because they broke the law.

Tharit Charungvat
Director-General, Department of Information
Ministry of Foreign Affairs
Bangkok

As seen by CBS

SIR – Your article “The not-so-big four” (April 11th) is certainly dramatic, but is excessively negative and misleading. Your claim that “broadcast television is declining at an accelerating rate”, while true for some, is not the case with the CBS television network, where ratings are higher this season then they were a year ago.

Over the past four decades many have predicted the demise of the broadcast medium. Yet we continue to deliver higher numbers of viewers than our media competitors, night after night. We believe our business model will prevail, not “collapse abruptly”, as you predict. And we believe news of the impending death of the magazine business is also premature.

Gil Schwartz
Executive vice president
CBS Corporation
New York

Fuelling debate

SIR – Your article is an example of how society fails to properly evaluate the technologies needed to fight climate change (“Biofools”, April 11th). Instead of identifying the best solutions, you focus on a worst-case scenario and reach a misleading conclusion. The problem is not biofuels, but agricultural methods in general. In fact, biofuels can actually have a positive impact on agricultural emissions. When the benefit of animal feed by-products resulting from biofuel production is taken into account, there is an increase in yield from an acre of land and required fertilisers.

We need to recognise that growing plants for food, feed and fuel is part of a complex and dynamic agricultural system providing multiple products, all of which are needed if we are to look after the planet, and to feed and fuel 9 billion people. Biofuels can make an important contribution to a more sustainable

and climate-friendly agriculture.

Claus Felby
Professor, wood and biomass science
University of Copenhagen
Copenhagen

The following letter about biofuels appears online only

SIR – Regarding the contribution of biofuels to the flux of nitrous oxide, it is important to note that some liquid biofuel technologies also increase carbon dioxide in the atmosphere and adversely affect the environment in many other ways. Directly burning biomass to co-generate heat and electricity is preferable to using the biomass to produce liquid biofuels such as ethanol, both to maximise the efficiency of use and minimise environmental harm.

Robert Howarth
Professor of ecology and environmental biology
Cornell University
Ithaca, New York

The following letter appears online only

Mosque and state

SIR – Your review of Ali Allawi's book ("The choice facing Muslims", April 18th) fails to note the false dilemma posed in the author's premise. The choice facing Muslims is not one between Islam and Western modernity. As a theistic, revealed religion Islam may offer its adherents many benefits. But it is not fit for use as the basis of government in a secular, multicultural, democratic society. This is not a limitation unique to Islam; the supremacy of the Christian church was similarly rejected in the Reformation. Those cultures that identify themselves as "Islamic" face many challenges. In order to meet them, their leaders must start by being honest about what Islam is and is not.

Gregory Newman
Aliso Viejo, California

Respect where due

SIR – *The Economist* owes Oakland's mayor, Ronald Dellums, an apology ("Killing for respect", April 11th). Mayor Dellums did not speak at the ceremony for the deceased police officers, not because he "had nothing to say at all", but because of a request from the family of an officer who had disliked the mayor.

Russell Bruno
Oakland

A jarring note

SIR – So "40% of Americans believe Placido Domingo, a famous Spanish opera singer, is Italian" ("Big in America?", April 11th). Perhaps 60% of Americans know that he is more Mexican than Spanish, having grown up and developed as a singer in Mexico?

Emilio Falco
Tubac, Arizona

Pakistan and the Taliban

A real offensive, or a phoney war?

Apr 30th 2009 | BUNER, ISLAMABAD AND SWAT
From The Economist print edition

As the Pakistani army launches a new assault on the Taliban, America hopes it is now more serious about defeating the militants

AFP

WHEN Barack Obama unveiled his new policy on Pakistan and Afghanistan in March, he gave a warning that al-Qaeda, the Taliban and other jihadist gangs were "killing Pakistan from within". The generals who guard Pakistan's national security had shown only "mixed results" in combating the threat, he said. They would no longer enjoy a "blank cheque"; they must show that they are fighting in good faith.

On April 26th, Pakistan gave a glimpse of this: by launching an attack on the Pakistan Taliban in parts of North-West Frontier Province (NWFP) recently overrun by the militants. It began with an assault in Lower Dir, near the border with Afghanistan, in which the army claims to have killed 70 militants and lost ten soldiers, and which displaced some 30,000 people.

On April 28th the army launched a bigger offensive in the scenic Buner valley, just 100km (62 miles) from Islamabad, Pakistan's capital. As helicopter gunships and jets strafed their positions, the Taliban took around 70 policemen and soldiers hostage. But showing more resolve than it had previously, the army said airborne troops had been dropped behind Taliban lines and freed 18 of the captives. Major-General Athar Abbas, a military spokesman, said 50 militants had been killed in the first two days of fighting. He said it would take a week to drive the Taliban out of Buner.

This sudden violence seems to have been provoked, in part, by embarrassing media reports of the Taliban's capture of Buner. Many of the bearded fighters had come from the neighbouring district of Swat, a Taliban stronghold, where NWFP's government, at the army's urging, had brokered a ceasefire with the militants in February. Under the terms of this pact, the government promised to institute Islamic law, *sharia*, throughout the Malakand division (whose seven districts, including Swat and Buner, make up about a third of NWFP's area). In return, the local Taliban, led by a zealot called Mullah Fazalullah, were to lay down their arms.

The Taliban's advance into Buner, which had resisted Talibanisation, was a violation of the deal, but at first neither the government nor the army seemed concerned. America, which had opposed the Swat deal from the start, was furious. On April 22nd Hillary Clinton, the secretary of state, said Pakistan was becoming a "mortal threat" to the world; its government and people needed to "speak out forcefully against a policy that is ceding more and more territory to the insurgents". On April 25th she expressed concern for the safety of Pakistan's nuclear arsenal if the Taliban were to "topple the government".

Some Western diplomats considered this scaremongering. The Taliban are near Islamabad because the capital, a 1960s new town, was built close to the rugged border area where these Pushtun tribesmen live. But there is no chance of their seizing Islamabad. If, unthinkably, the disparate warlords who make up the Pakistan Taliban were to mass together for a frontal attack, Pakistan's army, which is 620,000-strong and well-drilled for conventional warfare, could crush them. Indeed, many pundits reckon that an Islamist takeover in Pakistan would be possible only with the army's support.

The Taliban, almost exclusively Pushtun, are not popular in Pakistan. Though often anti-American, and bothered by a growing extremist fringe, most Pakistanis are moderate. Unlike some Taliban leaders, Mullah Fazalullah is not known to have links to al-Qaeda. Yet Mrs Clinton's warning points to an uncomfortable fact: since 2001, despite lavish American sponsorship, including over $10 billion in military aid, Pakistan has only become more turbulent and violent.

Even the country's president, Asif Zardari, has conceded that the Taliban hold "huge amounts of land". The army deserves much of the blame. During a seven-year campaign in NWFP and the Pushtun tribal areas adjoining it, where 120,000 troops are currently deployed, it has oscillated between fighting militants and making deals that, typically, give militants the run of their areas in return for a promise (rarely kept) of good behaviour.

The Taliban in Pakistan are linked by ideology and Pushtun tribal kinship to those fighting in Afghanistan. In South and North Waziristan, two ever-hostile tribal areas, the local commanders, including Baitullah Mehsud, leader of the Pakistani Taliban, are widely believed to play host to al-Qaeda's core leadership. They also send their long-haired gunmen across the border to fight Western and Afghan forces.

For America, Britain and other Western countries there is a direct connection between militancy along the lawless "Af-Pak" borderlands and jihadist bombings in Western cities. Yet Pakistan is the biggest victim of the militant tide. Around half a million people are estimated to have been displaced by fighting in the north-west. From their havens there, many jihadist terrorist groups have launched attacks on the state. Pakistan has suffered over 60 suicide-bombings in each of the past two years, on hotels, restaurants and mosques in Peshawar, Lahore and Islamabad, and on army facilities. Benazir Bhutto, Mr Zardari's wife, a two-time former prime minister and leader of the Pakistan People's Party (PPP) who was murdered in December 2007, was one high-profile victim. Foreigners are also at risk. In Peshawar, NWFP's increasingly nervy capital, two Afghan diplomats and one Iranian have been kidnapped. America's consul last year had her (bulletproof) car sprayed with bullets.

Even if the Taliban cannot conquer Islamabad, they might soon grab some lesser strategic place—just imaginably, Peshawar; or they could close down the motorway linking it to Islamabad. Mr Obama's new policy, which treats Pakistan as the main threat to regional stability, is intended to arrest this slide. It will come with a lot more money, including $1.5 billion a year in non-military aid over the next five years. At a conference in Tokyo on April 17th America, Britain, Japan, Saudi Arabia, South Korea and other "friends of Pakistan" also pledged $5.3 billion in budget support and other aid. Pakistan will be expected to provide better accounting for how it spends this money; for years its squandering of America's war-on-terror cash has been an open joke.

The mess in Malakand

Like a spectre, the Malakand ceasefire had been waiting to test America's renewed commitment to securing Pakistan. It was agreed between NWFP's provincial government and a veteran Swati Islamist, Sufi Muhammad, who is Mullah Fazalullah's father-in-law, shortly before the inaugural visit to Islamabad of Richard Holbrooke, Mr Obama's "Af-Pak" envoy. America considered the pact yet another abdication to the Taliban by an army that has sometimes inexplicably underperformed. By one Western estimate, it has lost 70% of its battles against the Taliban. It has also lost over 1,500 soldiers.

Another cause for alarm is that Swat is not like the tribal areas, which have always been largely beyond the writ of Pakistan. Swat, by contrast, is a thickly populated former tourist destination, famous for honeymooning couples and Pakistan's only ski-lift. The Taliban's capture of Swat therefore contained a promise of further militant expansion, even into Punjab, Pakistan's richest and most populous province. Nor, judged on the failure of earlier deals, did the ceasefire ever seem likely to weaken the militants, as the government hoped it would. When it was eventually approved on April 13th by Mr Zardari after much anxious foot-dragging, an American spokesman said it violated the principles of democracy and human rights.

But most Pakistanis seemed to welcome the deal, believing it would end recent carnage in Swat. Since mid-2007, when Mullah Fazalullah and his followers took up arms in protest at an army raid on a jihadist citadel in Islamabad, the Red Mosque, they have blown up 200 non-Islamic schools in the district, beheaded scores of government workers and alleged spies, and periodically kidnapped companies of soldiers sent to fight them. Preaching class warfare, as well as *jihad*, they have seized hundreds of houses and landholdings, including many of Swat's prized orchards. Half of the district's police officers and many administrators have fled, as have most landowners. Around 800 people have been killed, most during a heavy-handed army action that began last October, and displaced at least 100,000 people.

AP

The Taliban in Buner, with Koran and Kalashnikov

The Taliban behaved repellently during that offensive. Residents of Mingora, Swat's biggest town, awoke daily to find still-dripping corpses littering its central plaza, or dangling from lamp-posts there. They dubbed it *Khooni Chowk*, or "Bloody Square". Yet almost all agree the army killed more civilians than did the militants. "The army was aiming its shells at ordinary people. Or else, did they hit our houses every day by mistake?" asks Fazal Rahman Nono, a local resident.

If few Swatis have much love for the Taliban, practically none say they want a military operation to dislodge them; nor do the army and NWFP's government. General Abbas says that if the army had continued with its last offensive in Swat, "the whole valley would have been flattened". He also defends the ceasefire deal; he says it has isolated the radical Mullah Fazalullah by bolstering Mr Muhammad, who was until recently in prison and disgrace, having led an army of Swatis to be slaughtered by American bombers in Afghanistan in 2001.

But far from muzzling his son-in-law's jihadist invective—which Mullah Fazalullah once broadcast regularly, earning himself the moniker "Mullah Radio"—Mr Muhammad has echoed it. Ahead of a rally on April 19th to celebrate Mr Zardari's signing of the ceasefire accord, Mr Muhammad was allegedly primed by the provincial government to tell the Taliban to disarm. Instead, addressing a crowd of 40,000 in Mingora, he denounced Pakistan's constitution and said democracy was for infidels. Similarly, Mullah Fazalullah's commanders say the deal is a first step to imposing *sharia* throughout Pakistan.

They clearly have no intention of ceding Swat to the government. Instead, the ceasefire has enabled them to tighten their grip on it. Last week they occupied the office of Médecins Sans Frontières, an NGO, in Saidu Sharif. In early April, they occupied the northern Swati town of Bahrain, and on April 28th shot and injured one policeman there and kidnapped another. Speaking by phone, a local resident says: "Ours is a life of fear and death." Yet the government could probably have lived with this, if the Taliban had not embarrassed it by taking Buner.

A step too far

On April 24th, four days before the army launched its offensive, the Taliban leader in Buner, Commander Khalil, welcomed your correspondent to his requisitioned house in the village of Sultanwas. He claimed to have been sent to the district by Mullah Fazalullah to check that *sharia* was being followed, in accordance, he said, with the terms of ceasefire agreement. Yet he and his men had proceeded to chase away the district police and a few local resisters, killing eight. They then looted every government and NGO office and well-to-do house or business they could find. Pointing to a large trove of stolen computers, American-donated food aid and jerry-cans of petrol, he said: “We'll give them to the poor, who really need them. These houses also belonged to rich people, who ran away when we arrived because they were scared to face our justice.”

America is delighted by the army's subsequent assault in Buner; a Pentagon spokesman called it “exactly the appropriate response”. Some American officials believe the army will even resume its offensive in Swat; and this time crush Mullah Fazalullah. Such optimism might seem justified by a modest improvement in Pakistan's fortunes on other fronts. Courtesy of an IMF loan of $7.6 billion, the offerings of its friends, and some penny-pinching economic management, it is no longer at risk of insolvency, as it was late last year. And in March, skilful diplomacy by the army and America averted a political crisis sparked by Mr Zardari's efforts to have his more-popular rival, Nawaz Sharif, rendered ineligible for election. If Pakistan now has a window of relative political and economic stability, could Malakand prove to be a turning-point in Pakistan's flagging war with extremism?

Probably not. The government has made no effort to use the ceasefire to extend its writ in Swat. Nor has it announced any plan to abrogate the deal. And the army shows little sign of wanting to resume the fighting in Swat. If this suggests Pakistan's top brass may, under pressure from America, be doing no more than the minimum (or slightly less than that) demanded of them, it would not be for the first time. One of the tricks used by the former president, Pervez Musharraf, was to arrest a few of the former jihadist assets of the army's Inter-Services Intelligence (ISI) agency; then later release them.

America has endured many such false hopes in Pakistan. Another was in early 2007 when the ISI backed a Taliban commander in South Waziristan, called Muhammad Nazir, to expel some Uzbek militants who had found refuge there. The army suggested that foreign militants would no longer be welcome in the tribal area. But Mr Nazir did not evict his Arab terrorist guests, and in February he declared a new alliance with South Waziristan's main Taliban commander, Mr Mehsud, the alleged mastermind of Ms Bhutto's murder.

In a more recent setback, Abdul Aziz, head of Islamabad's Red Mosque, was released from jail on April 16th. He had survived the army's assault on the mosque (though over a hundred, and perhaps many more, of his followers did not) by fleeing dressed in a black burqa. Within hours of his release Mr Aziz was back in the pulpit, claiming credit for the introduction of *sharia* to Swat, and predicting the same for all Pakistan.

Another act of Pakistani slipperiness, the government's failure to dismantle the latest incarnation of the Lashkar-e-Taiba (LET) terrorist group that is alleged to have carried out a murderous commando-style attack in Mumbai last November, may be most troubling. In response to strong American, British and, naturally, Indian pressure, it arrested half a dozen mostly mid-level LET members, and vowed to try them for this crime. But there is little prospect that the group's senior leaders, currently under house arrest, will face justice. And the government has already failed in its obligation to take over LET's assets, which include schools, dispensaries and hospitals. In Punjab, which is home to LET (a group formerly trained by the ISI to fight in Indian-held Kashmir), the government has taken over 20 LET schools and five hospitals. Yet the group is estimated to retain control over an estimated 50-70 other properties, which it holds in other names.

Pakistan's failure to suppress LET invites the thought that the army has not entirely abandoned its old proxy. And it still considers India, against whom it has fought three full-scale wars, to be its main enemy. To some extent, this obsession with India illuminates the army's troubles in the north-west. By maintaining its readiness for a conventional war on Punjab's plains, it has been slow to acquire the necessary counter-insurgency skills; hence its brutish reliance on artillery fire in Swat.

Worse, the army stands accused of protecting some of its former militant allies in the tribal areas, to preserve them for future (or perhaps current) use in Afghanistan and Indian-held Kashmir. This allegation is often cited to explain the army's failures. But there is rarely evidence for it. Increasingly,

though, senior American officials decry Pakistan's obsession with India. General David Petraeus, chief of America's Central Command, argues that Pakistan faces greater danger from home-grown extremism. With a smile, General Abbas suggests he doesn't think much of this: "When people come here and tell us about our neighbour, how good or bad he is, allow us to take it with a pinch of salt."

Rigid, deceitful and, it seems, convinced that Islamist militancy poses a much lesser threat to Pakistan than America reckons, the army will always be an awkward ally along the north-west frontier. Then again America is a difficult friend for Pakistan. Its pressing objective is to stanch the flow of Taliban into Afghanistan and to crush al-Qaeda's leadership; these are not priorities for many Pakistanis. And if the Pakistani army's efforts against the Taliban have not been successful, it reasonably counters that the cross-border insurgency has been inflamed by America's own blunders in Afghanistan and its missile strikes into Pakistan.

The army considers that it takes a longer-term view of what is required for its troubled north-west. In Swat, for example, it seems to think it would be fruitless to pulverise the Taliban, and in the process kill many civilians, while Pakistan's civil institutions are too weak to fill the vacuum that would be created. This is not entirely unreasonable. Local dissatisfaction with Pakistan's slothful and corrupt justice system—so much worse, Swatis say, than the traditional system of modified *sharia* that it replaced in 1969—has helped fuel Mullah Fazalullah's insurgency.

Many also seem to believe that, once *sharia* is instituted, the brutal militants will fade away. Inam-ur-Rahman, head of the Swat peace committee, a group that speaks to both the army and Taliban, says: "For God's sake, let's implement the deal. It will bring peace." Alas, that sounds naive. But even a government determined to crush the Taliban will struggle without the support of the local population. "Even if you take a Pushtun person to paradise by force, he will not go," adds Mr Rahman. "He will go with you only by friendly means."

Obama's record

A hundred days of hyperactivity

Apr 30th 2009 | WASHINGTON, DC
From The Economist print edition

Buoyant polls and a defecting senator put Barack Obama in a strong position

Reuters

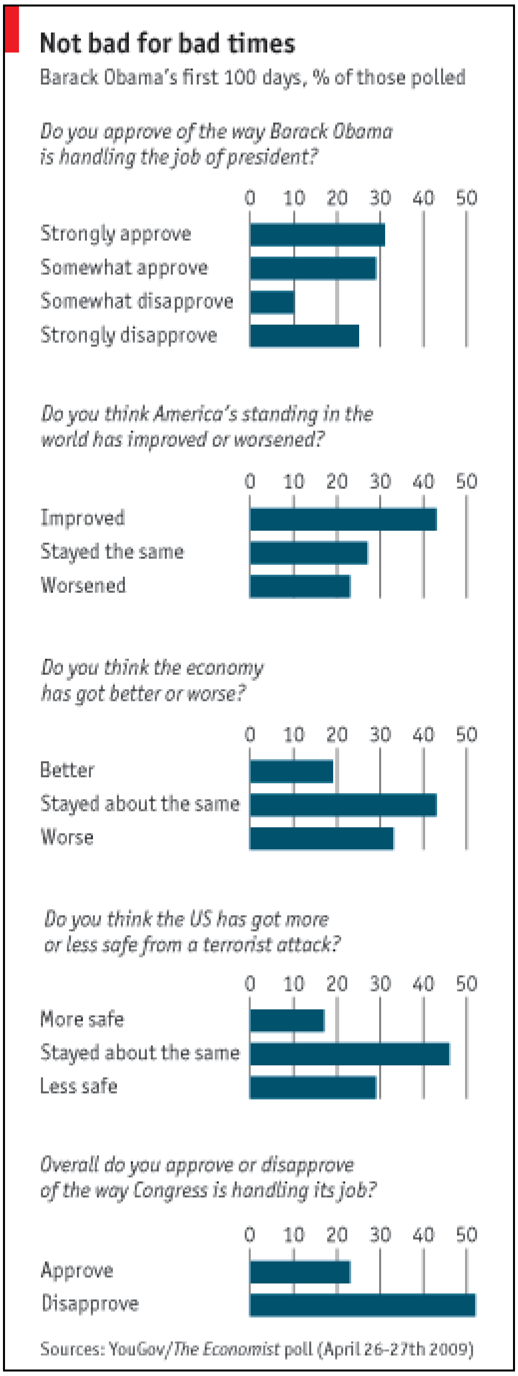
ON APRIL 27th a large passenger jet flew low over Manhattan, closely pursued by a fighter aircraft. Unsurprisingly, New Yorkers panicked. Few were amused to discover later that the plane was Air Force One, and that the White House had ordered it to buzz the Statue of Liberty for a publicity photo. For Barack Obama's detractors, the incident perfectly captured the new president's penchant for style over substance. "Wouldn't Photoshop have been cheaper?" asked a conservative blogger.

After 100 days in office, Mr Obama is still scorned by the people who scorned him as a candidate. But they are a minority. A YouGov/Polimetrix poll for *The Economist* (see left) found that fully 70% of Americans like Mr Obama as a person. Many are struck by his intelligence and wholesome family, complete with new dog. Few can see in him any personal vices worse than the occasional cigarette.

Mr Obama scores less well as a president than as a person, but not much. YouGov found that 60% of Americans like the way he is handling the job. Other pollsters put the number even higher. In general, Mr Obama is much more popular than Congress and slightly more popular than the policies he espouses. So long as this lasts, he is in a strong position to cajole Congress into approving his agenda.

On April 28th, his position grew even stronger. Arlen Specter, a Republican senator from Pennsylvania, announced that he would defect to the Democrats (see article). If the Democrats also win a disputed seat in Minnesota, as seems likely, Mr Specter's defection would give them a 60-vote supermajority in the Senate. This would make it much easier for Mr Obama to pass his two big domestic proposals: heath-care reform and a cap-and-trade

system for curbing carbon emissions. However, Mr Specter said he would continue to oppose a bill that would let unions dispense with secret-ballot elections.



Mr Obama is both cursed and blessed to have taken over in the middle of a blazing financial crisis. Cursed, because he has had to spend his first 100 days frenziedly fire-fighting. Blessed, because no one blames him. Even as joblessness soars and Americans' savings turn to cinders, Mr Obama wins plaudits for acting boldly to douse the flames. He has enacted a huge fiscal stimulus, unveiled a hyper-Keynesian budget, propped up tottering car firms and hastily drafted new rules for how financial bail-outs will proceed.

No one knows if Mr Obama's fiscal firehose will work. The economy shrank at an annualised rate of 6.1% in the first three months of this year, as businesses slashed inventories and cut investment by a shocking 38%. This makes the current recession at least as bad as any since the second world war. And it is unlikely to end soon: the commercial property market is groaning and swine flu is sure to cause jitters.

Republicans protest that since the money Mr Obama is spraying about is borrowed, he is dooming the nation to higher taxes in the future. On April 15th, the day by which Americans must file their taxes, hundreds of thousands held "tea party" protests against Mr Obama's plan to double the deficit.

But overall, Americans are much more optimistic about the economy since Mr Obama took over. Most think he is handling economic issues well. Most do not mind if he increases the size of government to tackle the crisis, so long as he scales it back when it is over. Strikingly, 45% of Americans now think the country is on the right track, up from a miserable 15% before Mr Obama was elected. The stock-market, too, is up by a quarter since its low point on March 9th.

Mr Obama has been able to keep some of his campaign promises without Congressional say-so, simply by signing executive orders. In January, he ordered the closure within a year of the prison for terrorist suspects at Guantánamo Bay. This delighted his supporters, but he has not yet decided what to do with the detainees, and has not ruled out detaining some of them indefinitely. In March, he gave an order to lift George Bush's restrictions on federal funding for stem-cell research, while delegating the task of drafting more detailed ethical rules to the National Institutes of Health. And in April, he lifted some restrictions on Cuban-Americans travelling and sending money to Cuba.

Abroad, Mr Obama has won applause. He was received warmly during a visit to Europe, where audiences appreciated his promise to show more respect for world opinion than his predecessor did. Republicans berate him for exuding weakness, noting that his big speech on nuclear disarmament was upstaged by a North Korean missile test. Democrats retort that Mr Obama can be tough when necessary. He has fired missiles into Pakistan to kill suspected Taliban fighters hiding there. And he is ramping up the war in Afghanistan even as he withdraws troops from Iraq. Republicans snipe that however much foreigners may like Mr Obama, they are still not prepared to send many troops to help America in Afghanistan.

Some of Mr Obama's biggest headaches are being aggravated by his own party. He has banned "waterboarding", a form of torture that was used on at least three al-Qaeda members thought to have information about impending attacks. But he is resisting his supporters' demands that Bush-era officials be prosecuted for authorising such methods of interrogation. His reluctance may stem from the knowledge that his own party is also complicit. For example, Nancy Pelosi, the speaker of the House, was briefed about waterboarding and raised no objections.

Plus, he has bigger priorities. He is trying to save what is salvageable of the American car industry. He wants to reshape the American health-care system, which is nearly a fifth of the economy. He wants to tackle climate change, but has not yet begun to explain to voters that this will raise their energy bills. His honeymoon will not last for ever. If he is to build on the promise of his first 100 days, he must spend his political capital cautiously.

Obama and trade

Low expectations exceeded

Apr 30th 2009 | WASHINGTON, DC
From The Economist print edition

Though Barack Obama has shown less protectionism than was feared, he needs to do more to resist it in Congress and to press forward on Doha

THE president has shown signs of shedding the protectionist baggage he brought to the White House. As presidential candidate, Barack Obama wanted to punish China for manipulating its currency to boost exports. On April 15th President Obama's treasury secretary quietly issued a report that pointedly did not declare China to be a currency manipulator. Candidate Obama promised to renegotiate the North American Free-Trade Agreement to insert tougher labour and environmental standards. President Obama has told the leaders of Canada and Mexico that the deal can be left as it is. Candidate Obama opposed ratification of the free-trade agreements (FTAs) that George Bush had signed with Colombia and South Korea. On April 18th President Obama talked to Colombia's president, Álvaro Uribe, about how to move their FTA forward.

The first deal likely to be approved under Mr Obama would be a relatively uncontroversial FTA with Panama, although it has snagged on American demands for more help in catching tax cheats. The president remains adamant that South Korea should do more to admit American cars. But the momentum has clearly shifted. After North Korea carried out a missile test early in April, Max Baucus, the senior Democratic senator on trade matters, and Charles Grassley, his Republican counterpart, urged Mr Obama to move the South Korean FTA forward to help a "steadfast ally". And though congressional Democrats have not dropped their concern over the violent treatment of Colombian union leaders, they are ready to deal with this without reopening the treaty, raising the prospect of passage by the end of the year.

Such changes of heart are noteworthy but they do not yet make Mr Obama a free-trader. Rather, they reflect the natural movement from campaign effusion to foreign-policy priorities. Picking a fight with China played well during the Democratic primaries, but today it would cast a pall over joint efforts to revive the global economy. Similarly, Hillary Clinton as presidential candidate was more protectionist than Mr Obama, but now as secretary of state she appreciates the diplomatic value of strengthening such allies as Colombia and South Korea.

There is still much ambivalence. Doug Irwin, a trade economist at Dartmouth College, notes that the White House website's agenda lists 24 items from civil rights to urban policy, but not trade. "They don't have a trade policy," says Mr Irwin. "They want the issue to go away."

Trade, though, keeps forcing its way into the president's lap. Protectionism is fermenting in Congress and in some unions, and Mr Obama's resistance has been intermittent. When legislators inserted "Buy American" provisions into this year's $787 billion fiscal stimulus plus restrictions on the ability of banks that received bail-out money to hire workers on temporary provisional visas, the administration persuaded Congress to water down both provisions though not to eliminate them. Another provision, in a separate spending bill, which cancelled a pilot programme for Mexican trucks to operate in America (allowed for by the North American trade agreement), went through unaltered. The administration is, however, now trying to revive the programme.

Mr Obama did not endorse any of these restrictive provisions, but his inability to stop them suggests a deference to protectionists and an unwillingness to spend political capital in defence of free trade. And bigger tests are coming. Charles Rangel, the top Democrat on trade issues in the House of Representatives, has introduced a bill that would toughen enforcement of existing trade laws in ways that could run foul of World Trade Organisation (WTO) rulings. And the United Steelworkers' union has asked for duties to be imposed on Chinese tyre imports under a little-used law known as Section 421. This does not require proof that imports break trade laws, only that they hurt someone, and it gives the administration discretion whether or not to impose duties. It will be Mr Obama's "most important litmus test", says John Veroneau, a Bush trade official. Mr Bush rejected all four Section 421 petitions that reached him. If Mr Obama yields, "There will be a line up the street of petitions."

An even more important test is his approach to reviving the Doha round of trade talks. Ron Kirk, Mr Obama's trade ambassador, said in his first big speech on April 23rd that the administration is committed to a successful conclusion of Doha. Jagdish Bhagwati, a trade economist at Columbia University, dismisses such talk as "a pious assertion with little operational content".

Mr Kirk did promise more detail in coming weeks on how he proposes to revive Doha. But it is difficult to find anyone in Washington who thinks it can be done this year. The proposed cuts to agricultural tariffs are deeply unpopular among farm-state legislators, and little pressure is felt from business or indeed America's trading partners. By contrast, bilateral agreements like the Colombian and South Korean FTAs offer concrete foreign-policy benefits.

Perversely, they may also erode support for Doha by diluting the benefits that individual countries get from a worldwide reduction in trade barriers. Those benefits have been considerable in the past. Matthew Adler and Gary Hufbauer of the Peterson Institute, a think-tank, reckon American exports would be 7% lower and imports 6% lower if tariffs reverted to where they were before the Uruguay round of reductions, completed in 1994. On April 24th Pascal Lamy, head of the WTO, attributed the administration's paucity of public comment about Doha to a need to work out its own strategy. Mr Kirk's speech, he said, was a hopeful sign. He added: "I can't restart the process without the US being ready."

Dachshund racing

Dogs in a hurry

Apr 30th 2009 | BUDA, TEXAS
From The Economist print edition

Stubby-legged racers take off

Illustration by Claudio Munoz

ROSCOE, a piebald dachshund, was the runt of his litter. No one wanted to buy him. So the breeder gave him to Jeremy Dingle, who soon realised that he had a special pup, now a top dog in the dachshund-racing world. Fresh from victory in Lubbock, Texas, Roscoe was a potential winner as he prepared this week for the semi-final of the Wiener Dog Races in Buda.

Dachshunds, sometimes known as wiener or sausage dogs, are one of the most popular breeds in America. Racing the little creatures got a boost in 1993 when it was featured in a beer advertisement. Now there are dozens of races each year, mostly in southern and western states. (New England eschews the pastime, although there are fancy-dress parties for dachshunds in New York's Washington Square Park.) The largest event, the Wienerschnitzel Wiener Nationals in southern California, sponsored by a chain of hot-dog restaurants, attracts tens of thousands of visitors.

A wiener dog at full throttle, flying down the lane with his ears inside out and tongue flapping, is a sight worth seeing. And the races return some civic benefits. The Buda event, in which no fewer than 468 dachshunds were taking part, is sponsored by the local Lions Club and has proved to be their best fund-raiser. Proceeds go to scholarships, summer camps and eye care.

The Dachshund Club of America is opposed to wiener-dog racing on the ground that it is hard on the dogs. But at this point the competitions are hardly cutthroat, and the racers are pets first and foremost. In Buda, one owner bragged that her dachshund could catch a bee in its mouth, and release it unharmed.

The young sport is even the subject of a new documentary film, "Wiener Takes All". Shane MacDougall, the documentarian, says that people track him down every week for advice on how to start their own races. Researching the film during the phase of the Iraq war when anti-French sentiment led some Americans to call their chips freedom-fries, he stumbled upon a historical coincidence: during the first world war patriotic owners renamed their dachshunds "liberty pups". "I think we just need to send more wiener dogs to the United Nations," suggests Mr MacDougall.

Spreading electricity

A gust of progress

Apr 30th 2009 | CHICAGO
From The Economist print edition

Creating windpower transmission in the Midwest

FRANKLIN ROOSEVELT helped bring electricity beyond America's cities to its most distant farms. Barack Obama hopes the countryside will return the favour. Much of this challenge rests in the gusty upper Midwest. In recent years Interstates 29 and 80, highways of America's heartland, have teemed with lorries bringing wind blades to new plants. Efforts to build transmission have moved more slowly. There are 300,000 megawatts of proposed wind projects waiting to connect to the electricity grid, says the American Wind Energy Association. Of these, 70,000 megawatts are in the upper Midwest.

Now action is at last replacing talk. Firms are proposing ambitious transmission lines across the plains. The region's governors and regulators are mulling ways to help them. The federal government is playing its part. In February the stimulus package allotted $11 billion to modernise the grid. Since then members of Congress have proposed an array of bills to develop transmission. Jeff Bingaman, chairman of the Senate energy committee, intends to start marking up transmission plans next week—though debate over other parts of the energy bill may delay progress.

America's grid is complex: 3,000 utilities, 500 transmission owners and 164,000 miles (264,000km) of high-voltage transmission lines are stretched across three "interconnections" in the east, west and Texas. If wind is to generate 20% of electricity by 2030, as in one scenario from the Department of Energy, about $60 billion must be spent on new transmission. Just as important, regulations must change.

Historically, electricity has been generated close to consumers. Regulations are ill-suited for transmission across state borders. Rules for allocating a project's costs burden local ratepayers rather than distant beneficiaries. One state's regulators can scuttle a regional plan. The process for seeking approval from federal agencies is so disjointed and slow that pushing a line over a national park or river might as well be crossing the Styx.

American Electric Power (AEP) built a transmission line from West Virginia to Virginia in two years. The approval process had taken 14. "There are lots of people with authority to make pieces of the decision," explains Susan Tomasky, president of AEP Transmission, "and no single entity that can say 'yes' or 'no'." Despite recent changes, the Federal Energy Regulatory Commission (FERC) has limited power to make projects go faster.

Fortunately, officials have started to address these problems. In September 2008 the governors of the Dakotas, Iowa, Minnesota and Wisconsin formed an alliance to co-operate on regional planning. Midwest ISO, which supervises 94,000 miles of high-voltage lines, is considering ways to spread the costs of new transmission beyond local ratepayers and taking part in preparing a broad plan for the eastern interconnection.

Federal legislation will help too. Harry Reid, the Senate's Democratic leader, Mr Bingaman and Byron Dorgan of North Dakota have offered three of the most prominent proposals. Each would require comprehensive plans for the interconnections, and would, to varying degrees, expand FERC's authority to locate big new projects and allocate their costs.

Initiatives like this would help to encourage firms already eager to invest. Two of the most ambitious plans belong to AEP and to ITC Holdings, which each want to build lines from the upper Midwest to cities farther east. In April FERC offered ITC's "Green Power Express" initial incentives to push the project along.

However, even quick progress in the world of transmission is slow. If all goes according to schedule—an unlikely thought— the Green Power Express would still not be in service until 2020. Fights in Washington are inevitable. FERC's role in siting projects is controversial. More important, this debate may be bogged

down by broader ones, such as the fight over a mandate to make a greater share of electricity from renewable sources. Meanwhile the winds whistle across the plains.

The postal service

You've got (no) mail

Apr 30th 2009 | NEW YORK
From The Economist print edition

The postal service has been hit hard by the recession and by faster competition

ENGRAVED magnificently above the columns of the main post office in Manhattan is a promise of the postal service's resilience. "Neither snow nor rain nor heat nor gloom of night", runs the motto, "stays these couriers from the swift completion of their appointed rounds." Inclement weather is one thing, but the downturn is posing a greater challenge. Starting on May 9th, New York's main post office, which prides itself on being open 24 hours a day, will close its overnight window. Other post offices round the country may close down completely.

This recession has been particularly cruel to the postal service, already battered by the popularity of e-mail. Last year saw the biggest decline in mail since the Depression: volume fell by 4.5%, or about 9 billion pieces. The postal service ended the 2008 fiscal year with a $2.8 billion loss, and the next two years may well be worse. "No one knows at what point mail volume will bottom out," said the postmaster-general, John Potter, in his testimony before the Senate in January. He thinks the service could lose as much as $6 billion in 2010.

Congress has encouraged the postal service, which is an independent agency under the control of the executive branch, not to rely on government money and to function more like a company. It has not given the agency a handout since the early 1980s. So Mr Potter has been trying to cut costs. The country's third-largest employer, the postal service is reconfiguring delivery routes, reducing work hours and cutting staff through attrition. It is raising rates to try to bring in more revenue, and also planning a summer sale to entice businesses to send mail in bulk at discounted rates. Some of its biggest customers, the housing and financial industries, have sharply reduced their direct-mail budgets because of the recession. The postal service wants to lure them back.

In spite of these cost-cutting measures, Mr Potter knows that, without help, the service could run out of cash by the end of the year. He has asked Congress to consider changing the law and allowing the postal service to cut deliveries from six days a week to five. A Gallup poll shows that most Americans would rather see a cut in services than an increase in stamp prices or a government bail-out. But not everyone agrees. Businesses, which send advertisements in bulk, will be fierce opponents of any reduction in delivery days. And fewer deliveries may give the impression that the mail is slower and less reliable than it was before the recession.

Mr Potter has also asked Congress to modify a 2006 law that requires the service to pre-pay employees' future retirement benefits. It is the only agency that does such a thing, and delaying the payments would save $2 billion this year.

The timing of Mr Potter's call for help was inopportune, to say the least. He never asked Congress directly for a bail-out in his testimonies before the House and Senate, but he was in the company of CEOs from the car, insurance and financial-services sectors who did. False reports that Mr Potter earned $800,000 in 2008 tended to distract from his cause. "We're not asking for a handout," he says.

Whatever action Congress takes to help the postal service weather the recession, a larger question looms. Will new technologies kill the mail? Letter-writers and advertisers are increasingly going online, and customers are paying their bills over the internet. Postal services in other countries are experimenting with offering electronic mail services to customers; some have expanded into banking too. But the Postal Accountability and Enhancement Act of 2006 actually forbids America's postal service to do anything but handle the mail—in snow, rain, heat and gloom, and in the teeth of possibly mortal competition.

Statewatch: Rhode Island

Little Rhody in the red

Apr 30th 2009 | NEWPORT AND PROVIDENCE
From The Economist print edition

America's smallest state has mammoth economic problems

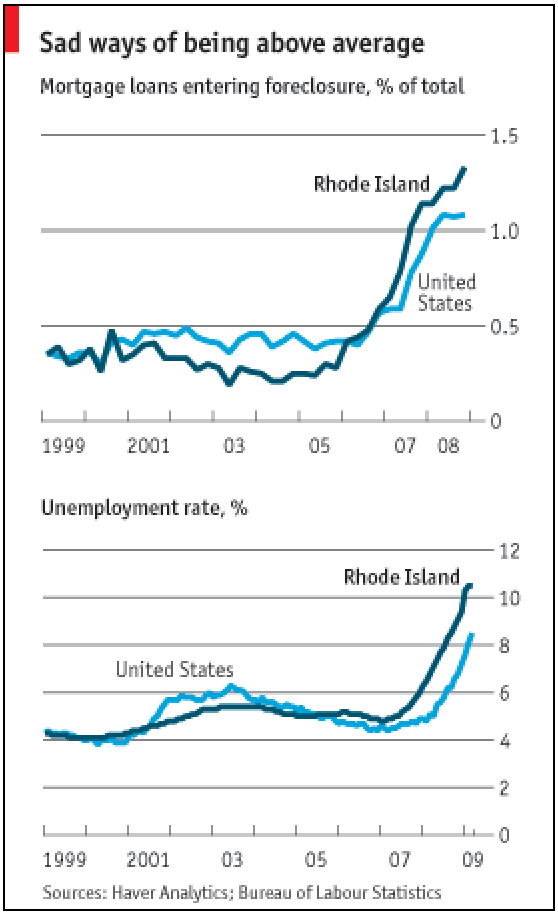
THE mansions of Newport, one of Rhode Island's most popular tourist attractions, were once the mere summer "cottages" of the industrialists of the Gilded Age. Marble House, playhouse of the Vanderbilts, is said to have cost $11m, $7m of which was spent on 500,000 cubic feet of marble.

Today almost no homes, opulent or otherwise, are being built in Rhode Island. Only 16 permits for single-family dwellings were issued in February in the whole state. In March 633 homes were in foreclosure. The job front looks even worse. Last September Rhode Island had the highest unemployment rate in the country, exceeding even Michigan. In March the rate was the sixth-highest in the country, 10.5%, compared with 8.5% nationally.

Almost every sector has been affected. Jobs are so scarce that 200 people turned up recently at a job fair hosted by Foxy Lady, a Providence strip club. But the current misery comes on top of long-term decline. The state's once thriving manufacturing industry has been fading for decades, with production slowing and working hours cut. Manufacturing lay-offs were persistent, even during good times; and good times have not been seen in the state for almost two years. Rhode Island entered the recession six months before the rest of the country.

Lose your job and your house

The subprime crisis hit early and hard. Jennifer Weiner, of the Federal Bank of Boston, says housing prices rose more steeply than in the rest of the country and began to drop sooner. Though New England has mostly avoided huge numbers of foreclosures, Rhode Island was not as fortunate. Its foreclosure rate in 2008 was 35% higher than in Massachusetts and 64% higher than in Connecticut. That first wave has been followed by a second, as the unemployed and the underemployed find it hard to pay their mortgages. Unfortunately, many of the homes now being foreclosed are three-and four-family houses. Tenants are often given only two or three days to leave.



The Housing Network of Rhode Island is seeing an increase in people seeking help. One in ten Rhode Islanders is enrolled in the food assistance programme and plenty more are eligible. Immigrants, many of them Dominicans working mostly as cleaners or maids in the service industry, are especially vulnerable. The monthly current conditions index, produced by Leonard Lardaro of the University of Rhode Island, indicates that service employment jobs, a leading labour-market indicator, dropped by 20.5% in February.

People are leaving the state in droves to find jobs. Others are being taxed out. The state government has been putting more pressure on a dwindling pool of taxpayers. The state has only 1m residents, of whom only 465,000 are working. Some 8,300 families, with incomes of around $485m subject to tax, left the state between 2005 and 2006. Anecdotal evidence suggests that the exodus has continued since the downturn began.

The state's budget problems are chronic. Deficits are not unusual. Rhode Island has a budget gap of $372m for the year that ends on June 30th. This is about 11.4% of the state's total budget. According to the Council of State Governments, it is among the highest in the country. The future looks bleaker. Revenue collections are down by $13.8m. The Rhode Island Public Expenditure Council, an independent research group, says the state faces long-term deficits over the next decade. The 2011 fiscal year will probably show a $156m deficit. The gap will continue to widen to a potentially crippling $482m in 2014.

The Tax Foundation, a non-partisan public-education outfit based in Washington, DC, has consistently judged Rhode Island's tax climate to be one of the worst in the country. Donald Carcieri, the state's governor, is pushing a plan to phase out the 9% corporate tax rate. This would improve the state's ranking from 46th to 16th in friendliness towards business—which might create job opportunities and retain talent. At present, though 80,000 students attend college or university in the state, few stay once they graduate.

Ed Mazze of the New England Economic Partnership places the blame for the mess firmly in the hands of the governor and the legislature. He is angry that they wasted time trying to coax some big firms to move to the state, while jobs were leaving. But Laurie White, of the Greater Providence Chamber of Commerce, notes that "despite the cruelty of the economic times, or maybe even because of the cruelty of the economic times…[job-creating] projects are gaining traction."

Greenery to the rescue

The state's Economic Development Corporation (EDC) sees Rhode Island as a leader in green technology. It is working with Deepwater, a windpower company that will manufacture wind turbines in the state. Michael Saul of the EDC thinks the skills of boat-builders (as Rhode Islanders used to be) will translate to building wind turbines, and hopes that these will eventually appear all along the eastern seaboard.

The state also wants to become a biomedical centre. The warehouses of Providence's Jewellery District, once home to hundreds of costume jewellers who have since moved south or abroad, are filling up with small laboratories, mostly specialising in neural and genome research. The highway that currently cuts off the district from the rest of central Providence is being moved elsewhere; this will open up 19.5 acres (7.9 hectares) for lab development and commercial space. Attracting talent shouldn't be a problem: Providence is just 45 minutes away from Boston and three hours from New York. And Rhode Island has a tradition of bringing tourists in.

The state may have hit bottom already. Unemployment remained steady from February to March. As Mr Lardaro dryly notes, "We can see the light at the end of the tunnel. Let's hope it's not a train." If things don't look up, the state may reconsider a 1971 proposal to impose a $2 levy on each act of sexual intercourse performed in the state. Only men would pay.

Lexington

Party-hopping

Apr 30th 2009
From The Economist print edition

Arlen Specter has shifted the balance of power in Washington yet farther to the left

Illustration by KAL

THIS week was always going to be a gloomy one for the Republicans, with Barack Obama celebrating his first 100 days in office and the media singing “hallelujah”. But the mood got a lot gloomier on April 28th when one of the most senior Republicans in the Senate announced that he was switching parties.

Arlen Specter’s statement could not have been better timed from the White House’s point of view. Just as Obama was about to hit the 100-day milestone, the press was suddenly obsessed by the spread of swine flu. Mr Specter’s party-hopping not only shifted the spotlight back onto politics. It also provided the White House with a perfect opportunity to hammer home one of its favourite messages: that the Republican Party is becoming such a rump of Rush-Limbaugh-worshipping fanatics that sensible people have no choice but to back Mr Obama.

Mr Specter explained his decision to switch parties by saying that his vote in favour of Mr Obama’s stimulus package had caused an irreconcilable schism with Pennsylvania’s Republican Party, particularly the hardcore members who vote in primaries. But in truth he could probably have pointed to any number of irreconcilable schisms with his former party. Mr Specter parted ways with the Republican Party because the Republican Party is ceasing to be a viable force in Pennsylvania.

Mr Specter faced a strong challenge in next year’s Republican primary from Patrick Toomey, a fierce conservative who has been ahead of him in the polls by some 20 points, buoyed by white-hot Republican fury at the Obama administration and generously financed by the low-tax, minimal-government lobby, the Club for Growth. And even if he had survived Mr Toomey’s onslaught, he would then have had to perform the difficult trick of moving back to the centre to beat a Democrat. Why subject himself to trial by fire when he could simply switch party?

Mr Specter’s party-hop will dramatically change the political terrain that Mr Obama faces in his second 100 days, all but guaranteeing the Democrats control of the 60 seats in the 100-seat Senate that allows them to pass legislation without the threat of a filibuster. The only thing that now stands between them and this supermajority is Norm Coleman and his interminable legal battle to prevent his Democratic rival, Al Franken, from being seated, and that battle looks increasingly doomed.

Yet the supermajority may not prove to be the cure-all that many Democrats hope. Party discipline is much looser in the Senate than in the House—and an inveterate maverick such as Mr Specter is not going to cease behaving like one. In his statement he insisted that he would not be “a party-line voter any more for the Democrats than I have been for the Republicans.” He also noted that his opposition to a law to make union organising easier will not change. Moderate Republicans, like Susan Collins and Olympia Snowe, will undoubtedly find themselves voting with their old colleague often enough in the future.

But Mr Specter’s decision nevertheless changes the dynamic on Capitol Hill. Hitting the magic 60 will change the psychology of life in the upper house, emboldening the Democrats and enfeebling the Republicans. And shifting parties will subtly change the thinking of even such an independent as Mr Specter. He will no longer have to keep a wary eye on his right flank, particularly over judicial appointments. He may also find that the simple fact of caucusing with Democrats nudges him farther to the left. Thus Mr Specter’s move will both increase Mr Obama’s chances of getting his domestic agenda through Congress and boost his ability to put liberals in the courts.

Mr Specter’s decision is yet more proof that the once mighty Republican Party is in a perilous state—abandoning the middle ground of politics to the Democrats and retreating into an ideological and regional cocoon. A recent *Washington Post*/ABC News poll revealed that the proportion of Republicans had shrunk from 25% in late March to just 21% today, the party’s lowest figure for more than a quarter of a century. That compares with 35% for Democrats and 38% for independents. A recent Democracy Corps poll also shows that Mr Obama enjoys a 16-point advantage over the Republicans on the economy, a 24-point advantage on heath care and a 27-point advantage on energy policy.

Even these dramatic numbers may understate how bad the situation is for the Republicans. The party is rapidly disappearing in whole swathes of America. The proportion of Republicans among 20-somethings has reached its lowest ebb since records began to be kept after the second world war. Just two and a bit years ago Pennsylvania had two Republican senators. Today it has none, and there are precious few in the entire north-east.

Club for shrinkage

Mr Specter argued that he had almost no choice but to abandon an increasingly shrunken and hardline party. More than 200,000 Pennsylvania Republicans, most of them suburban moderates, shifted their party identification to the Democrats during the last election cycle, giving Mr Obama a ten-point victory in the state and leaving Mr Specter at the mercy of an ever-diminishing band of hardliners. Mr Specter’s particular nemesis, the Club for Growth, is proving to be a Club for Shrinkage.

The Republican Party would be wise to think carefully about its loss of Mr Specter, one of America’s best known senators, whose views are shared by many old-line business-friendly Republicans. Some clearly realise what a mess their party is in. Ms Snowe described his decision to jump ship as “devastating” both “personally and then for the party”. But all too many others were content to respond with lame jokes (“I read that he was switching parties, but was disappointed to learn he’s still a Democrat”) and even lamer declarations of ideological purity.

Economist.com / blogs / lexington

Latin America's economies

Pain but no panic

Apr 30th 2009
From The Economist print edition

A traditionally crisis-prone region is belying its reputation. But that has not spared it from the world recession

Illustration by S. Kambayashi

UNTIL recently many Latin Americans saw the financial crisis and the global recession as events happening somewhere else. But in the past six months the region's economies have swiftly slumped along with the rest of the world, showing double-digit falls in industrial output. Workers have been laid off in Mexican car factories, Brazilian aircraft plants and Peruvian building sites. For Latin Americans such woes are sadly familiar: income per person in the region has fallen on five separate occasions since 1980. What is different this time is that Latin Americans are faring no worse than the rest of the world. And there are reasons to believe that their recession may be relatively short and mild. That may not be cause for celebration but it is a crumb of comfort.

The bad news is, however, quite bad. Latin American countries have been hit by four different recessionary forces. As the financial crisis in the developed world transmuted into a collapse of manufacturing, trade plunged: total exports for five of the region's larger economies fell by a third between August and December, partly because fewer goods were sold and partly because the price of commodities fell.

The flow of capital to the region also dried up, leading to a steep rise in borrowing costs for governments and companies. The Institute of International Finance, a bankers' group, thinks that net private capital flows to Latin America will fall by more than half this year compared with last, to $43 billion (down from a record $184 billion in 2007). Foreign banks have trimmed credit lines, especially for trade. In addition, remittances from Latin Americans working abroad have begun to contract, and fewer tourists have come visiting.

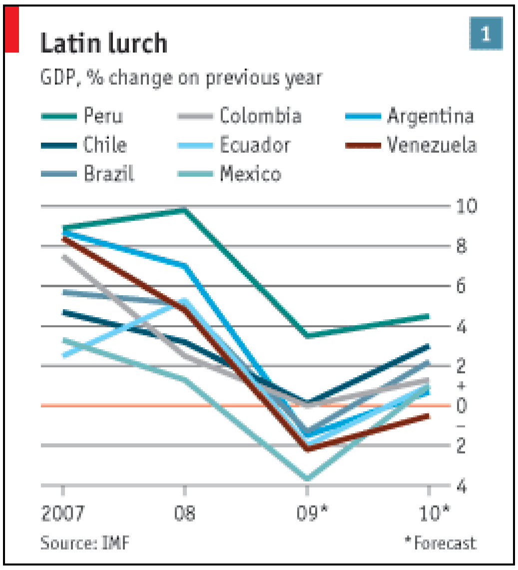
Most forecasters think that GDP in Latin America and the Caribbean as a whole will contract slightly this year, but a moderate recovery will follow next year. The IMF, for example, predicts a contraction of 1.5% in 2009 and growth of 1.6% in 2010. With the population growing at 1.3% a year, income per person will shrink.

All this brings an abrupt end to five years in which economic growth averaged 5.5% amid generally low inflation. This golden demi-decade also saw social progress: according to household surveys, poverty fell

from 44% in 2002 to 33% last year, when 182m people were classed as poor; the region's wide inequality of income narrowed; and tens of millions of Latin Americans joined an emerging lower-middle class.

Just how bad the recession will be varies markedly from country to country (see chart 1). Countries with close ties to the United States' economy—Mexico and much of Central America and the Caribbean—will fare worse than the regional average. In Mexico the fall in output was still accelerating in February, and the disruption caused by the outbreak of swine flu will make things worse (see article).

By contrast, countries such as Brazil whose exports are more diversified, spanning different markets as well as products, or those whose economies are relatively closed, will be hit less badly. In Brazil there are already signs that recession will be short. Guido Mantega, the finance minister, points out that more Brazilians were hired than fired in March. Many forecasters expect Peru's economy to buck the regional trend by growing this year and next, partly because it exports much gold, whose price has held up, and partly because it has a fat pipeline of foreign and public investment projects.



Lessons learnt

The good news is that things might be much worse, and in the past usually were. The three classic Latin American sources of weakness—financial systems, currencies and the public finances—have not been an independent source of woe this time, as Augusto de la Torre, the World Bank's chief economist for Latin America, points out. In the case of financial systems, that is partly because they are relatively small and undeveloped (paradoxically, this was often cited as a drag on growth). But it is also because most were tightly regulated, the result of lessons learnt the hard way over the past quarter-century. So the banking system is not acting as a magnifier of recession.

A decade ago governments in many of the larger countries in the region reacted to a previous bout of financial-market turmoil by switching from fixed to floating exchange rates. They backed these up with more responsible fiscal policies, and by requiring their central banks to target inflation. In contrast to the practice during previous booms, Latin America maintained a current-account surplus (and so accumulated reserves), and paid off public debt.

In this group of countries (Brazil, Mexico, Chile, Peru and Colombia among the larger ones), these policies are now proving their worth. The currencies of several of them depreciated by around 30% when money fled emerging markets in the weeks surrounding the collapse of Lehman Brothers last September. But devaluation, which will help exports, has not led to panic. In contrast to past recessions, when governments were forced to raise interest rates to defend the currency as well as to cut spending, this time they have been able to take steps to mitigate recession. Several of the larger economies have announced fiscal measures to stimulate demand, averaging around 1% of GDP. Some have done more: both Chile and Peru promise to raise public spending by around 10% this year, much of it on infrastructure such as roads and housing. It is not yet clear how much extra spending will happen in practice.

As important, central banks are cutting interest rates steadily (see chart 2). They have scope for further cuts. They have also taken other measures to provide credit. Brazil's Central Bank, for example, stepped in to provide dollars to help companies to repay foreign debt. It also allowed commercial banks to draw down some of the funds they are required to deposit at the Central Bank in normal times. As a result of these actions, credit is gradually returning, says Henrique Meirelles, the Central Bank's president. Peru's Central Bank has taken similar steps. State-owned development banks in Mexico, Chile and Brazil have all stepped up their lending.

The dissenters

Other countries have taken a radically different approach. Venezuela, Argentina and Ecuador have pursued expansionary fiscal policies in recent years, and their populist governments have harassed the private sector and foreign investors. All have fairly rigid exchange rates: Venezuela's bolívar is fixed, Argentina has long intervened to manage the peso and Ecuador uses the dollar as its currency. The growth of public spending in these countries was highly dependent on the commodity boom. To sustain spending, Argentina and Ecuador have raided pension funds while Venezuela's government has plucked reserves from the Central Bank. Venezuela's public debt is low and it can tap local banks for loans, but it is the only one among the region's bigger economies to have announced a cut in public spending this year.

The IMF reckons that these three will be among the worst-performing Latin American economies, along with Mexico's, though it thinks Mexico will recover more quickly. Many economists believe that the longer the world recession lasts, the greater the risk that Ecuador, Argentina and Venezuela (in that order) will run out of money. Supporters of these governments point out that the IMF's past growth forecasts for Venezuela and Argentina have been unduly pessimistic. All three countries are looking to China for support: Venezuela and Ecuador have signed investment agreements, and Argentina has a currency-swap line aimed at reducing its need for dollars. But such help may be inadequate.

Other governments are starting to queue up for support from the IMF. This month Mexico arranged a loan of $47 billion under the fund's new flexible credit line. Colombia has requested a similar loan of $10.4 billion. This credit is designed for countries with sound policies and carries no strings. Buttressing the balance of payments in this way gives more scope for interest-rate cuts without triggering currency weakness, says Nicolás Eyzaguirre, the IMF's top official for Latin America.

Even in the better-run countries, the scope for fiscal stimulus is limited. Only Chile, which saved the equivalent of 12% of GDP in a special fund during the boom, can repeat the dose for several years from its own resources. As recession bites, tax revenues are falling everywhere and public deficits rising. Mr de la Torre predicts that in the region as a whole fiscal revenues will fall as a proportion of GDP from 24.4% in 2008 to 21.2% this year. The multilateral banks are stepping into the breach. The World Bank will lend about $14 billion to the region in the year to June, and a similar amount in the following 12 months, up from a recent annual average of $5 billion, according to Pamela Cox, the bank's vice-president for the region. The Inter-American Development Bank (IDB) has also increased lending, to $15 billion a year. It is seeking to raise more capital.

The big fear in the region is that the longer the recession lasts, the more difficult it will be to sustain government spending without additional aid. That is because the vast stock of public debt to be issued by rich countries may crowd out Latin American borrowers. Researchers at the IDB argue that aid should be geared more to helping government refinance public debt than to providing further stimulus. Unlike rich countries, this argument goes, Latin America may gain more in the medium term by defending its hard-won fiscal stability and relying on the outside world for stimulus.

But there will be political pressure to do more. Already recession has halted some of the social progress of the past few years. Even if the recession is short and mild, the result will be 6m more Latin Americans in poverty than would otherwise be the case, estimates Marcelo Giugale, a poverty specialist at the World Bank. Of these, 4m are people whose incomes will sink below the poverty line, while 2m are people who would have risen above it had it not been for the recession. Mr Giugale notes that traditionally recessions in the region see an increase in child malnutrition and in teenagers dropping out of school to seek money in the informal economy. Public-health provision deteriorates both because budgets are cut and because demand rises as some middle-class Latin Americans can no longer afford private health insurance.

In social policy, too, the region is better placed than in the past. A dozen countries have cash-transfer schemes aimed at tackling extreme poverty in rural areas. In some countries, such as Mexico and El Salvador, governments have increased payments under these schemes. Many are looking at expanding their coverage. Peru is trying to extend the provision of free school meals to cover family members.

In the 1980s poverty rose steeply in Latin America, and public services and investment were slashed. There are reasons to hope that it can be different this time. Seven months after the financial crisis hit the region, pain is spreading but not turmoil, nor is economic stability being lost. “If the world economy rebounds, Latin America can rebound,” says Mr Eyzaguirre. The question is when that will happen.

Paraguay

The boy and the bishop

Apr 30th 2009 | ASUNCIÓN
From The Economist print edition

Paternity claims distract from a struggle for reform

AP

How many more little Lugos are there?

A FEW days before Good Friday, the sky in Asunción, Paraguay's capital, became dark and the clouds poured black rain over the city and left it smelling of ashes. In a Catholic country where a former bishop was elected as president a year ago, such unusual happenings were taken by some as a portent. And lo, the day after Easter the president, Fernando Lugo, admitted to having fathered a child. The boy is almost two years old, which means that Mr Lugo had stopped acting as a bishop when he was conceived. When his affair with the mother started she was aged 24 and he 55. Since Easter two other women have claimed that Mr Lugo fathered children with them too. The padre, whose moral authority swept away six decades of corrupt rule in Paraguay by the Colorado party, now finds himself mocked as "the father of all Paraguayans".

A lot now hinges on whether these subsequent claims turn out to be true. Paraguay is not as strait-laced as some countries in the region, partly because of the unusual family arrangements that sprang up after a 19th-century war that wiped out many adult males. Mr Lugo gained some credit for owning up to his secret, even if the confession was forced upon him by the boy's mother, who had become frustrated by intermittent and meagre alimony payments. If the other children turn out to be his too, Mr Lugo will be damaged.

That may hinder him in trying to augment the modest achievements of his first nine months as president. Some signs suggest that the police force is being shaken up. A drive against corruption means some public-sector jobs are now advertised. And Mr Lugo has appointed an effective health minister, and instituted cash transfers for Paraguay's poorest.

But his government has mainly been marked by his tendency to promise too much and do too little. Brazil squashed his plan to renegotiate a treaty under which electricity from Itaipu, a giant hydro plant, is shared by the two countries. He announced and then withdrew a subsidy for sesame growers. A promised land reform has been delayed by the need to draw up a land registry.

Blame for drift lies with the president, says Fernando Masi of CADEP, a think-tank. "He doesn't understand, and doesn't want to know, how the state works." During a recent presentation of the government's plan for dealing with the effects of the world recession, Mr Lugo was spotted with his head in a breviary.

Getting to grips with Paraguay's problems would be hard even for someone with more political cunning than Mr Lugo. Public administration is plagued by the fact that until he took over all civil servants were required to be members of the Colorado Party. None can be sacked; many have been moved round in an attempt to break up old mafias. This has had the unfortunate effect of removing the competent ones from their posts. Some civil servants still send other people to clock in for them. The state's authority is also contested by smugglers, drug-traffickers and workers in its own customs houses, which bring in 60% of tax revenues.

Mr Lugo is further hampered by a lack of political infrastructure. Having no party of his own, and no majority in the legislature, he relies on the support of others. This means that anything his government does has to be accomplished through persuasion and backroom deal-making of a kind for which he shows little appetite.

As for Mr Lugo's paternity problems, "if he does well in the next two years, people will forget" about them, says Sebastián Acha, of Patria Querida, an opposition party, "just like with Clinton." Mr Acha knows the president well, and was responsible for persuading him to address an anti-corruption rally in 2006 that was his first step towards national political prominence. He is gloomy about Mr Lugo's chances of transforming Paraguay. Given the obstacles the president faces and his now-diminished standing, the gloom may be justified.

Mexico's army

Barracks law

Apr 30th 2009 | MEXICO CITY
From The Economist print edition

Crimes that go unpunished

WHEN he took office as Mexico's president in December 2006, Felipe Calderón was faced with the unchecked and violent power of drug gangs and a corrupt and ineffective set of police forces. So he turned to the army, sending some 45,000 troops to patrol the streets in the most troubled cities. It was supposed to be an emergency measure. But the troops are still there, and since they are not trained for policing duties, perhaps inevitably from time to time there are allegations that they abuse their powers. What is less inevitable is that their crimes seem to be going unpunished.

Human Rights Watch, a New York-based group, has investigated 17 such incidents involving 70 victims. Its allegations, contained in a report released this week, are backed by eyewitness accounts and forensic evidence. They include gruesome tales of killings, torture and rape of people with no ties to the drug trade. Many of these cases had already been documented by Mexico's own government-backed human-rights commission, which has seen a fourfold rise in complaints against the army since Mr Calderón took office. But that body has no power to act on its findings.

Nearly all criminal cases against soldiers are handled by military courts, where they are treated as disciplinary matters rather than crimes. Military judges are appointed by the defence secretary, who can remove them at will. Their verdicts are not made public and victims cannot appeal to civilian courts. When asked by Human Rights Watch to provide details of any cases in which soldiers had been convicted of crimes, the defence ministry did not do so.

Mr Calderón has made reforming the judicial system a priority, winning approval for a constitutional amendment that makes the civilian courts more open and less cumbersome. But he has not touched their military counterparts. Polls show the army is popular and trusted. “Having military officers commit abuses is seen as the lesser evil,” says Raúl Benítez, a defence specialist at the National Autonomous University of Mexico. “People just want the army to protect them from the *narcos*.” Since he is relying so heavily on the army, it is hard for Mr Calderón to force it to submit to the law. But unless he does, he may face an overmighty force, and one that starts to lose the trust of Mexicans.

Economist.com WORLD ASIA

Myanmar after the cyclone

When the help dries up

Apr 30th 2009 | KYAUNDA
From The Economist print edition

One year on, cyclone Nargis is still taking a toll on its Burmese victims

AP

IF A few small gold earrings escaped the cyclone the villagers pawn them, otherwise they pawn their clothes. They complain that moneylenders advance only a fraction of the item's value. And, with an interest rate of 30% a month, they can rarely afford to redeem their collateral.

Life is still desperate for the survivors of cyclone Nargis, which crashed ashore a year ago killing at least 140,000 in Myanmar and devastating the lives of 2.4m others. In the village of Kyaunda, near the mouth of the Irrawaddy delta, almost every house was lost. The process of replacing them with inferior bamboo shacks is not yet complete. Paddy fields and aquifers are still contaminated with salt water. Fishing boats, and the fish themselves, were washed away. The greatest needs, locals say, are for food and shelter.

Initially the callousness and incompetence of Myanmar's ruling junta hampered the aid effort. Now the obstacles are a shortage of funds and foreign squeamishness about dealing with the junta. In the weeks after the disaster it blocked foreign access to the delta and stalled aid shipments. But some aid did soon reach the survivors, from international agencies already working in Myanmar. And ordinary Burmese people and monks gave crucial assistance. After a few weeks a tripartite mechanism involving the regime, the United Nations and the Association of South-East Asian Nations (ASEAN), the regional block, was established and eased barriers such as the visas aid workers need, and the permits required to import equipment.

The leaders of the international rescue operation insist that everyone received some assistance, and the feared secondary wave of deaths was averted. By October 2008 the UN's World Food Programme (WFP) had reached 1.1m people, exceeding the 920,000 it originally envisaged.

If basic needs were eventually met, however, the recovery phase has barely begun. Some 500,000 people still have no permanent home, 200,000 have no access to fresh water and 350,000 are receiving WFP food aid. Indebtedness has soared because survivors have no way of making a living. The problem, according to agencies, is a lack of funds. Only two-thirds of the original target for last year's appeal, of $477m, was achieved, a fraction of what Aceh, on the Indonesian island of Sumatra, received after the tsunami of December 2004. A fresh appeal for $691m for reconstruction for the next three years has

received only $100m so far.

There is a taboo against giving aid to Myanmar for fear of bolstering the dreadful regime. But the price may be the deeper suffering of its people. The country receives $2.80 per head in foreign aid, compared with $55 for Sudan and $49 for the communist dictatorship next door in Laos. In particular, almost no one wants to finance infrastructure; so schools, clinics, raised footpaths, fishing jetties and bridges in the watery delta have not been rebuilt.

A recent expression of this tendency is a controversial report from Johns Hopkins University in Baltimore, which called for a moratorium on aid to cyclone victims. The report alleged widespread misappropriation of aid and the use of forced labour by the army in the delta. It received withering criticism from aid agencies and diplomats.

The response to the report may show that attitudes to delivering aid in Myanmar are changing. Agencies working inside the country hope so: to respond to the cyclone some had to divert resources from other parts of the country where the situation is scarcely less awful than in the delta. They believe they have proved that, despite the huge problems, aid can be delivered effectively in Myanmar.

If they win the argument, the next question will be how to spend it. Most Western governments prohibit the routing of any of their aid money through the regime. Some Europeans are reconsidering even that, though the European Union this week renewed its sanctions directed at members of the junta and at the export of Burmese gems, timber and metals. Japan and some UN agencies already attempt to co-operate with the government on health and education. And some of the independent Burmese groups that emerged to help cyclone survivors are still active. It is hard to argue when they say they deserve some help from abroad.

Japan's opposition in disarray

Should he stay or should he go?

Apr 30th 2009 | TOKYO
From The Economist print edition

The opposition's indecision over its leader is manna to the ruling parties

AFTER months on the back foot, the government led by the Liberal Democratic Party (LDP) has regained the tactical advantage before a general election that Taro Aso, Japan's prime minister, has to call by September. The government is betraying a measure of competence in the face of the county's abrupt economic slowdown. In particular, the extra budget which the finance minister, Kaoru Yosano, unveiled in April could provide a useful stimulus of 2-3% of GDP in ways not very beholden to the party's usual interests. Mr Aso's approval ratings have risen from abysmal lows, helped by his robust stance in the face of a rocket that North Korea fired over Japan on April 5th.

Reuters

Ozawa practices back-seat driving

Yet Mr Aso has benefited most from the main opposition leader, Ichiro Ozawa, wreaking damage on his own Democratic Party of Japan (DPJ). In March Tokyo prosecutors indicted his political secretary, Takanori Okubo, for accepting illegal funds from a construction company with a history of lining politicians' pockets. Mr Ozawa has since neither resigned nor backed up his claim to be as pure as driven snow. Until the scandal, the general election looked likely to be a walkover for the DPJ, sweeping away a political system that has kept the LDP in near continuous power for more than half a century. Now voters are turning against Mr Ozawa. Two-thirds of those asked say he should resign.

For some in the DPJ, this is the realisation of a long-feared nightmare. For years, even when he used to be in the LDP, Mr Ozawa saw Japan's need for competitive two-party politics. He has long vowed to bring such a system about. Yet the scandal is a reminder that his politics remain an old-fashioned mix of money and power to bring home the bacon to his base in north-eastern Honshu, Japan's main island. Few DPJ modernisers openly decry his style because his efforts have also transformed a party of the urban middle class into a national force with broad rural support.

With the opposition in disarray, Mr Aso has the luxury of choice. Either he can push the stimulus through the lower house of the Diet (parliament) in May and then call a snap election—colleagues favour June 7th. Or he can bide his time in the hope of seeing DPJ anguish worsen. Prosecutors may present more details of Mr Okubo's case in June, after which the options for Mr Ozawa may narrow. Mr Aso also appears to crave the prestige of attending the G8 summit in Italy in July. Tokyo metropolitan elections that month will command all the energies of the LDP's junior coalition partner, New Komeito. So Mr Aso may favour an August election. For now, he is keeping his own counsel.

Diminishing prospects of a clear victory for the opposition DPJ, which controls the Diet's upper house, have led to a return of talk of a post-election "grand coalition" to break the deadlock. This is the favoured solution of the establishment's dinosaurs—octogenarian newspaper publishers and former prime ministers—who think that they should be arranging the affairs of state and who constantly meddle in politics as kingmakers. It is a solution proposed briefly by Mr Ozawa in late 2007, much to the horror of his party. But it does little to further the hope that politics might become more accountable.

The DPJ's agony over Mr Ozawa has yet to show itself in public. If he goes, he may intend to hand over to the party's secretary-general, Yukio Hatoyama, and then wield power from behind the throne. Yet many will call for someone outside the Ozawa orbit to lead the party, in which case Katsuya Okada, a 55-year-old former leader, is the favourite. The upright Mr Okada says that the DPJ should take two issues to the enemy's camp in the election campaign: ending the baneful practice, so common in the LDP, of political seats becoming inherited family sinecures, and banning all corporate donations.

The second of these issues might look awfully like an attack on Mr Ozawa. Yet Mr Okada shies from launching an open challenge. He says that half of his constituents berate him for being hard on Mr Ozawa, while the other half urge him to contest the leadership. Yet, typical of Mr Okada's ambivalence, he insists Mr Ozawa himself is all for banning corporate donations. An open split, says Mr Okada, who led the DPJ to abject defeat in the previous election, "would ruin our chances of taking over the government." So might the DPJ's dithering over the future of Mr Ozawa, not for nothing called "the Destroyer".

Taiwan and the WHO

A healthy development

Apr 30th 2009 | TAIPEI
From The Economist print edition

A shot in the arm for Ma Ying-jeou

Illustration by Claudio Munoz

AT LAST Ma Ying-jeou, elected president of Taiwan last year, has something to show for his efforts to patch up relations with China, badly frayed under his predecessor, Chen Shui-bian. On April 28th Mr Ma secured a long-sought breakthrough. After 12 failed attempts since 1997 to join the United Nations' World Health Organisation (WHO) as an observer, Taiwan has been invited to take part in the WHO's World Health Assembly in Geneva in May.

This will be Taiwan's first participation in a UN event since it lost its seat to China 38 years ago. It represents a big concession from China, which habitually bars Taiwan from any gathering that might suggest it has a claim to statehood. Taiwan will take part under the name "Chinese Taipei", used in sporting events such as the Olympics and regional groups such as the Asia-Pacific Economic Co-operation forum.

The move will be widely welcomed at a time when the world is grappling with its response to swine flu. Taiwan so far has reported no cases, but the years of exclusion from the WHO make it feel vulnerable. During the deadly SARS crisis of 2003, Chinese objections delayed WHO experts wanting to assess the situation in Taiwan for several weeks. Taiwan's government was already permitted some contact with the WHO, but as an observer to the assembly it will have broader access to its data.

The move is the first real sign that detente with China has transcended purely trade and economics. Last year Mr Ma eased tensions by reviving a tactful but discarded formulation that both Taiwan and China were part of China but each defined the term in its own way. He renewed contacts with the Chinese government, and reached agreements to boost business ties. The latest, signed in Nanjing on April 26th, include one on financial co-operation, which will eventually allow Taiwanese financial institutions to start operating on the mainland. Others will allow a sharp expansion in direct cross-strait flights and improve co-operation in fighting crime and repatriating fugitives.

Mr Ma has also called from the outset for a "diplomatic truce". He said Taiwan needed to stop competing with Beijing to add to the short list of 23 countries which recognise it rather than China. WHO membership, however, was a priority for practical rather than political reasons. Analysts say a deal has been under negotiation for months. Taiwan has rejected any offer that describes it as part of the People's Republic of China, and has insisted that the invitation come from the WHO, not Beijing.

Beijing-watchers in Taiwan say senior Chinese officials differed about how to respond to Mr Ma's request. They did not want to give Taiwan too much political leeway. But they worried that if they did not help him, the disillusioned public would give more support to the opposition, Mr Chen's pro-independence Democratic Progressive Party. They may also have realised that blocking a country of 23m people from important forums dealing with global health hardly improves China's image as a responsible global citizen.

China and Japan

The flowerpot man

Apr 30th 2009 | BEIJING
From The Economist print edition

Trying to escape history

HOSTILITY toward Japan runs high in China. The history of the harsh occupation during the 1930s and 1940s is neither forgotten nor forgiven. So it should come as little surprise that “City of Life and Death”, a new film about one of the most gruesome chapters of that history, the 1937 Japanese assault on the city of Nanjing, has done well in China, earning $10m in the first week since its release. But it must have irked Japan’s prime minister, Taro Aso, that the film was released on the eve of his first visit to China since taking office last September.

The range of issues confronting the two countries is daunting. Territorial disputes, North Korea’s continued dalliances with long-range missiles and nuclear bombs, and bilateral trade tensions demand attention, along with the global economic crisis and swine flu. But their shared past is always near the surface.

Mr Aso himself has helped keep it there. A week before the visit he donated a potted plant to Tokyo’s Yasukuni shrine, where Japan’s war dead are honoured, including 14 convicted war criminals from the second world war. Unlike some of Mr Aso’s predecessors, he did not visit the shrine himself. But the move was not well received in China. Nor, however, was it met with the sort of scathing rebuke that was once obligatory.

In years past Chinese leaders and the state-controlled press were quick to use such incidents to whip up popular resentment against Japan. Spurred on by the press (and by Japan’s own refusal fully to confront its wartime past), angry Chinese were unobstructed as they organised boycotts of Japanese goods and demonstrated, sometimes violently, against Japanese institutions.

Official anti-Japan rhetoric was noticeably toned down in the two years before last year’s Beijing Olympics, perhaps out of a desire to ensure a sportsmanlike reception for Japanese athletes and spectators. The games are now past, but the pressing need for a modicum of harmony in which to navigate the financial crisis together may be enough to keep the lid on all that unhappy history.

For Chinese who have seen “City of Life and Death”, what stands out most is its sympathetic portrayal of a Japanese soldier. This is a novel twist for Chinese treatments of the subject, and the film’s official sanction suggests a desire to promote more nuanced views. But the time may not be ripe. Lu Chuan, the film’s director, has received death threats and accusations of being a traitor and a stooge for Japanese revisionists.

The Philippines and America

The romance has gone

Apr 30th 2009 | MANILA
From The Economist print edition

But the dream lives on

A CHORUS of protest against the Philippines' military ties with America has greeted the acquittal on appeal of an American serviceman accused of raping a Filipina. Left-wingers are demanding the removal of American forces from Philippine soil. Politicians nearer the centre are calling for changes in the rules covering their presence. This is the latest touchy episode in a sensitive relationship between the Philippines and America, the former colonial power, in which Filipino national pride often obscures the national interest—and sometimes the interests of justice.

In a case that stirred nationalist passions, a court in December 2006 convicted Lance-Corporal Daniel Smith, an American marine, of raping a woman, identified only as “Nicole”, a year earlier. The court sentenced Lance-Corporal Smith to 40 years in prison. He was tried in a Philippine court, as decreed by the ten-year-old Visiting Forces Agreement (VFA), which governs the presence of American forces in the Philippines. At the time, the conviction was greeted by Filipino supporters of the military alliance with America as proof that it was an equal partnership, and that a previous era when American servicemen could commit crimes in the Philippines with apparent impunity was over.

However, Filipinos sceptical about the VFA soon smelled a rat. Lance-Corporal Smith was detained not in a Philippine prison, but in a converted freight-container in the American embassy compound, while he awaited the outcome of an appeal. Then, in March this year, it was revealed that Nicole had dismissed her lawyer and made a sworn statement to Lance-Corporal Smith's lawyers that she was no longer sure that she had actually been raped.

It was also revealed that Nicole had accepted 100,000 pesos ($2,000) in damages from Lance-Corporal Smith and that she had gone to live in America with her American boyfriend. When, on April 23rd, three female judges upheld Lance-Corporal Smith's appeal and set him free, calling the alleged rape a “romantic episode”, opponents of the VFA cried foul. Politicians expressed their outrage in the press, calling for the abrogation or amendment of the VFA, while protesters demonstrated near the American embassy. The government simply expressed satisfaction that justice had been done.

The government welcomes American forces because they give their Filipino counterparts much-needed training and equipment for coping with decades-old communist and Muslim insurgencies and the newer threat of international terrorism. Nationalists believe the Philippines is cringing before its former masters. But so they would. The most vociferous nationalists are from left-wing parties that carry the torch for the communists, whom the Americans regard as terrorists.

Amid the noise from the nationalists, the stars of this “romantic episode” appear to have been forgotten. Lance-Corporal Smith has spent over two years incarcerated in a container, is $2,000 out of pocket and his military career is probably over. And as for Nicole, to the embarrassment of the nationalists, many ordinary Filipinos envy her for living a dream many of them share: in America with $2,000 to spend.

Sri Lanka's humanitarian crisis

Exodus of misery

Apr 30th 2009 | COLOMBO AND PUTUMATTALAN
From The Economist print edition

The war grinds to a close, leaving a human catastrophe in its wake

Reuters

WITH loudhailers hitched to the tallest palmyrah trees, Tamil-speaking soldiers of the Sri Lanka army had for weeks been urging civilians inside a dwindling strip of territory held by the rebel Tamil Tigers to break through their cordon and flee. But since April 20th, when the army burst an embankment at Putumattalan, the authorities have been overwhelmed by the thousands pouring out. The Tigers' defences were less to keep the army out than to fence the civilians in.

The government had expected an exodus far smaller than the one which came, bringing 114,520 civilians in the next nine days. Since January an estimated 190,000 have fled. The UN's assessment that there were originally around 250,000 trapped civilians, dismissed as exaggerated by the government, now looks roughly right.

By the middle of this week, the UN was maintaining that 50,000 non-combatants remained in the Tiger-held areas, though the government said 15,000-20,000. The army, which after two years of pitched battles has cornered the rebels into a 5km (three-mile) stretch of land, says it has slowed down the offensive because of the difficulty of distinguishing rebels from civilians. They wear similar clothes. As one soldier in Putumattalan puts it, the only difference is the terrorist's weapon.

On April 27th Mahinda Rajapaksa, Sri Lanka's president, said he had told the security forces to stop using heavy-calibre guns, combat aircraft and aerial weapons that might cause civilian causalities. This followed the announcement by the Tigers the previous day of a unilateral ceasefire, promptly dismissed by Mr Rajapaksa as a ploy. TamilNet, a pro-Tiger website, accuses the army of continued fierce shelling despite the claims of a halt.

The Tigers have tightened their net around the remaining civilians, as their only hope of escaping a full-scale military assault. But some are still wriggling through. Struggling to cope with a flood of weak, traumatised and often injured people, the government has called for urgent international assistance. The UN, which launched a $155m appeal for Sri Lanka in February, will raise its target higher.

Most of the displaced are crammed into 32 internment camps in Vavuniya, with some sent to Jaffna and Trincomalee. On April 28th a spokesman for the UN's High Commissioner for Refugees said people at these sites had reached “breaking-point”. Some unfortunates are staying out in the open, in sweltering heat. Overcrowding is acute, and the UNHCR has asked the government to make more room available.

Conditions are certainly better than the hellish ones the civilians were enduring in the supposed no-fire zone. But Mahinda Samarasinghe, the minister for disaster relief, has admitted

shortcomings in the government's response. He said the real challenge was to resettle people in their villages as soon as possible.

Children are among the worst hit by the fighting. An internal UN document reports that of 6,500 civilians killed since February, over 500 were children. It estimates the injured at 14,000, including more than 1,700 children. The UN does not apportion blame for the deaths. Survivors have confirmed that the Tigers executed or maimed some of those who tried to escape. But activists argue that this does not absolve the army of its duty to try to spare civilians. As one puts it, a democratically elected government is judged by higher standards.

Foreign aid is coming, but not without strictures. While the army continues its relentless advance, the government is facing international calls for a ceasefire, even a temporary one, to allow trapped civilians to leave. It is also battling criticism over its refusal to let a UN team enter the no-fire zone to make an assessment, and fending off charges of breaking humanitarian law.

Some of the fiercest criticism is coming from India, where Sri Lanka is an issue in the ongoing, month-long general election, especially in the Tamil-majority state of Tamil Nadu. M. Karunanidhi, the chief minister there, this week called off a brief hunger strike when the Sri Lankan government announced the end of combat operations. Heretically for a leading Indian politician, his predecessor and main rival, Jayalalitha, has called for a separate Tamil homeland, to be "carved out" of Sri Lanka. Military victory for the Sri Lankan government seems tantalisingly close. But it may pay a heavy diplomatic price.

Banyan

Australia's Chinese entanglement

Apr 30th 2009
From The Economist print edition

For all China's commercial charms, Australia still looks to America as Asia's sheriff

Illustration by M. Morgenstern

NO COUNTRY in Asia or the Pacific is more clearly a beneficiary of China's industrial revolution than is Australia. Its coal fuels the power stations that keep that revolution churning. Its iron is in the steel for every other new building. Chinese demand for Australia's mineral riches drove the long boom that ended last year. It still provides Australia's best hope of avoiding the worst of the slump that has followed.

Last November, when China announced its first big, 4 trillion yuan ($586 billion) economic stimulus in response to the downturn, Kevin Rudd, Australia's prime minister, was among the foreigners cheering loudest, calling it "very good news". The sense of relief was understandable. Taking goods and services together, China is now Australia's biggest trading partner. The slump may slow this trend down, but not change its direction.

Yet on a recent visit to Canberra, a capital whose eerily empty streets and subterranean parliament suggest a Pyongyang without the dystopia, Banyan found politicians and policy pundits in a quandary over how to handle both China and the recent upwelling of popular Australian antipathy towards the Chinese government. For all that China is Australia's second-biggest export market, with huge potential for growth, it is also a dictatorial power whose policies anger many Australians. Moreover, its commercial expansionism is accompanied by growing military strength. Defence strategists, who are paid to think the worst, now see the biggest potential threat to Australian security not as an unstoppable influx of Indonesian boat people, but as China.

One by-product of the slump, a rash of Chinese companies snapping up stakes in Australian mining enterprises in response to tumbling share and commodity prices, has provoked a popular backlash. To the mining companies, the colour of China's money is dazzling. But, though the Chinese onslaught looks fractious and pell-mell, conspiracy theorists smell a state-driven attack on the commanding heights of Australia's economy. They have succeeded in whipping up an anti-China mood. In March Australia blocked China Minmetals' acquisition of OZ Minerals, a copper and gold producer, on security grounds. A ruling over an even bigger deal is pending, having been delayed until mid-June. This will cover the $19.5 billion bid by Chinalco, an aluminium company, for nearly 20% of cash-strapped Rio Tinto.

The government's decision, on whether national security is at stake in this transaction, may be the

hardest it has had to make since coming to power in late 2007. It seems certain that the prime minister wants the purchase to go through. If it does, it will lead to renewed charges in Australia and around the region that he is soft on China as it seeks to extend its tentacles. After all, Mr Rudd was once posted to Beijing for the foreign service. In 2007 Chinese diplomats at a reception nearly choked on their canapés when Mr Rudd, then leader of the opposition, made a speech in faultless Mandarin. The prime minister, John Howard of the (conservative) Liberal Party, looked on with ill-disguised fury. Then, in a speech at Peking University last year, Mr Rudd described Australia as China's *zhengyou*, its "true friend". Mr Howard had nailed his colours to the mast of Australia's alliance with the United States, and after September 11th relished being America's "deputy sheriff" in the Asia-Pacific region. Mr Rudd, by contrast, has urged world leaders to accept a greater role for China. The opposition sneers at him as China's "roving ambassador".

There is enough force in this accusation to unsettle Mr Rudd. In Britain for the G20 summit in early April, he was caught on camera squirming in embarrassment at being seated next to Fu Ying, China's sophisticated ambassador to Britain (and, before that, Australia). Yet the slur is misplaced all the same. Mr Rudd has few illusions about China. He once wrote a thesis on Wei Jingsheng, one of China's most persecuted dissidents. Briefly out of a political job a decade ago, he trudged around China alone trying in vain to collect unpaid debts for Western firms. Last year he watched the Chinese embassy in Canberra orchestrate squads of Chinese students in Australia to smother pro-Tibet demonstrations. It was, says one of Mr Rudd's friends, a crucial moment: the first time a foreign power had denied freedom of expression to Australians in their own homeland. When Mr Rudd spoke of *zhengyou* last year, he used it in the dictionary definition of the term, as a "friend who will give forthright admonition", as over China's handling of Tibet. China prefers *lao pengyou*, "old friends", preferably sycophantic ones.

A stake in Australia's heart

Indeed Mr Rudd appears to have a keener sense than Mr Howard of a growing strategic dilemma. On the one hand, Australia's crackerjack fit with the Chinese economy is reshaping Australia's trade and investment flows, drawing the country into a China-centred Asian orbit. On the other, Australia's security hangs on America's continued presence in the western Pacific. A long-awaited defence white paper that is soon to appear is expected to recommend heavily strengthened armed forces. A central question is what Australia should do as the primacy of the American sheriff fades and China's power grows. Worst of all for Australia would be if one day it had to choose between the United States and China—possibly over Taiwan.

The urge to avoid having to make such a choice partly explains Mr Rudd's idea of an Asia-Pacific community, a framework for regional co-operation that he mentioned last year. Misread as a vague expression of pan-Asian sentiment, this is in essence a possible plan of action. For a start, offer China a say in helping to build predictable economic and security norms for the region. As a Rudd adviser puts it of the Rio Tinto decision: what is the point of asking China to be a responsible stakeholder if it isn't offered a stake? But, if the attempt to tame China goes horribly awry, make sure America is still around to help sort out the mess.

Iraq

Searching for a phoenix in Basra

Apr 30th 2009 | BASRA
From The Economist print edition

The country's second city is in better shape than it was a year ago but its future is still shaky

Getty Images

"SECURITY has dramatically improved in the past year" versus "We don't know what'll happen when the foreign troops leave" are the competing mantras of Basra, Iraq's battered second city. Almost everyone agrees that the first claim is true. But no one is at all certain that harmony will persist when most of the Americans, who have recently taken over the leading foreign role in Basra from the British, themselves withdraw from Iraq in little over a year, if Barack Obama sticks to his proposed schedule. By the end of June combat troops are supposed to have withdrawn from all the towns. On every count—security, politics, economics, social life—Basrawis are cautiously optimistic. But they are queasily aware that things could well go wrong again.

Security improved drastically just over a year ago thanks to the "Charge of the Knights" ordered by the prime minister, Nuri al-Maliki, in late March 2008. Mr Maliki sent 30,000-plus Iraqi troops, closely mentored by teams of American marines, into the city to clean out the Shia militias. They killed hundreds of the 10,000 or so fighters on the streets. Many of the militia leaders fled to Iran, which had been supplying them with weapons, especially Katyusha rockets. British officers helped with logistics and other operational tasks, including the deployment of Predator drones from which Hellfire missiles caused carnage among the militiamen. But most of the 4,000 British soldiers remained in their base, played no part in the assault during its crucial first week and did none of the fighting. Despite official protestations to the contrary, the British had lost control of Basra. It was retaken by Iraqis largely under American tutelage, with advice from a handful of British officers.

Mr Maliki had become exasperated by the dominance of Basra's militias, who had chased the British army out of the city and imposed a reign of repression over the hapless inhabitants in the previous two years. In a city that once claimed to be the "Venice of the Middle East", vaunting a cosmopolitan tolerance, the militias had closed bars and barber shops, murdered women who disdained the veil and killed scores of people selling alcohol and pop-music CDs. Critics had been silenced or killed, and teachers had been afraid to discipline students. Several hospitals were taken over by gunmen. Professionals fled.

According to a Western police adviser, some 900 of the murders that took place in 2006, in a city of 1.7m people, remain unsolved to this day. The murder rate that year was some 40 times higher than Britain’s. In 2007 the figure was probably worse. Some say half of Basra’s 20,000-strong police force had been infiltrated by the militias. Many kidnappings and murders were committed by people in police uniforms. A sheikh of the al-Abadi tribe says the militias killed about 10,000 Basrawis during their two years’ reign.

The British army, seeking to cut deals with some of the militia leaders, most of whom owed allegiance to a radical young cleric, Muqtada al-Sadr, was pushed out of the city centre by roadside bomb and bullet and was eventually obliged to leave its riverine base in Basra Palace. Since then the troops, now numbering around 4,000, have generally stayed stuck at “the COB”, an airport 8km (five miles) west of the city officially called the Contingency Operating Base.

Just a few British service people still work in Basra proper, in the shabby but once grandiose Shatt al-Arab Hotel that serves as the Basra Operations Centre, known as BAOC, now the joint American-Iraqi command hub for military operations across Iraq’s southern third. The British have handed over their main military and civilian responsibilities to the Americans. Most British troops will have left by the end of May, with just 300-400 trainers, including naval ones, staying behind.

A limited legacy

In the months leading up to the Charge of the Knights, the militiamen used to launch an average of six rocket salvoes a day at the British in the COB. Few were lethal, but they drained morale—and, more important, made it impossible for the British to repair Basra’s rotten roads, bridges and sewers, or get out and about to regenerate civil or political life in the area.

In each of Iraq’s 18 provinces, a provincial reconstruction team provided by the governments of the American-led coalition was meant to lead the drive for economic and political revival. But almost no one in Basra’s team, led by Britain’s Department for International Development, had been allowed to venture into Basra proper for an entire year before the Charge. Reconstruction tasks were subcontracted to local Iraqis, many of whom creamed off millions of dollars of aid money, often without doing the job. In the past six years the British government has pledged £744m ($1.1 billion) towards rebuilding Iraq, much of it in the area under its occupation. Officials explain that a lump of that cash went on humanitarian tasks, such as helping displaced people. A National Audit Office report notes instances of fraud and corruption. The upshot is that British-sponsored reconstruction has been dismally sparse.

After the Charge of the Knights that is all supposed to have changed—and in some respects it has. Some 20,000 Iraqi soldiers are still in Basra, along with 800-plus American police trainers, all deployed in relatively small bases across the city, after the model prescribed by General David Petraeus in his successful “surge” conducted two years ago in and around Baghdad. “You cannot commute” when conducting a counter-insurgency, says a rueful British officer who helped the operation. “The Americans learnt the lesson that you’ve got to live among the people.”

Good riddance to malicious militias

Nowadays the arterial roads into Basra are monitored by checkpoints. Cars driving along all the city’s main roads must go through Iraqi military checkpoints every few hundred yards. Most notably, the Iraqi army, whose troops come mostly from outside Basra, holds sway over the police, still regarded as unreliable, even though their new commander, Major-General Adel al-Ameri, has sacked at least 4,000 members of his force in an effort to clean it up.

“The time of the ban on singing is over,” says Hatim el-Bechari, an ebullient businessman who wants to build a park in his city. After the Charge of the Knights, “The militias’ wall of fear fell down,” he says. “People no longer feel the militias are part of life,” confirms a Western diplomat.

Women still feel obliged to wear headscarves but dresses are sometimes gaudy. Fewer are cloaked in the black *abaya*. Half a dozen shops have been given licences to sell alcohol. Couples can

stroll along the Corniche by the Shatt al-Arab waterway, formed by the merging of the Tigris and the Euphrates 64km (40 miles) upstream.

In provincial elections at the end of January, most of the councillors, a notoriously incompetent and corrupt lot, were chucked out. Twenty of the new council's 35 members support Mr Maliki and his State of Law coalition, which did well across Iraq and particularly so in Basra, where people ascribed their new-found relative calm to his Charge of the Knights gamble. The new governor, Shiltagh Abboud Sharad, a mild-mannered professor of Islamic literature who went into exile for 28 years under Saddam Hussein, is a staunch Maliki man.

But Basra's resurgence is still far off. The governor complains that his notoriously lousy predecessor had already spent or earmarked the current year's entire budget, which in turn, according to the outgoing governor, was barely a quarter of what was required to mend the broken services of Basra. The city's proximity to the front-line meant that it never recovered from its pasting during the war with Iran from 1980 to 1988. Though the province holds 80% of Iraq's known oil reserves, it was sorely neglected under Saddam.

Since the Charge, the central part of the city has been spruced up. A few markets have been reopened and some pavements relaid. But basic services are still dire. Everyone complains that electricity cuts out for three or four hours a day, sometimes more, a problem widely considered worse even than violence and corruption.

The British government, in the words of a long-time Basra observer, has been "desperate to salvage anything from the past 12 months", after the previous five years of chaos and disappointment. It has provided start-up loans for businesses, and fosters youth-employment schemes. It bolsters a fledgling investment commission to woo foreign business. It has even sent a minister, Lord Mandelson, with representatives of 23 big British companies, to tour Iraq, including Basra (well, the COB). And it is holding a conference in London, with Mr Maliki in attendance, to promote investment. But so far few British firms, beyond the oil-and-gas giants, have taken the plunge to invest seriously in Iraq's south.

Panos

Once the militias had gone

For Basra still offers little of what is needed to lure outside investment. It has virtually no banking or insurance system, not even a top-class hotel, though one is said to be opening soon. Skilled workers are scarce. All big decisions are made in Baghdad. Red tape and corruption are rife.

Above all, security is still shaky. The police, despite improvements, are incompetent. There is no secure compound or office block where international companies would be confident to place their staff. Even today British officials do nearly all their business in the COB. Those who venture "downtown"—the phrase is mentioned as though Basra city is still another world—go barely once a week under carefully arranged routines. The Western police adviser, for instance, notes that in the course of the past year he has visited the city on average once every ten days. This correspondent, under the British aid ministry's aegis, was flown from the COB to Basra's operations centre and accompanied by a team of ten bodyguards provided by a security company on a tightly scheduled tour of the city. A saunter through the streets was evidently deemed unwise. In such conditions, no Western businessman from a middling firm is going to spend much time airing investment ideas in downtown Basra.

Fear and loathing in the suburbs

Moreover, despite the hammering the militias took a year ago, the fear of a resurgence of violence from Mr Sadr's followers has not disappeared. True, his front men won only a couple of seats in Basra's provincial election, indicating a slump in his popularity. Yet thousands of the sullen, jobless men who followed Mr Sadr and other Islamist radicals are still there, lying low in the vast, insanitary breeze-block settlements laid out in grids on the city's western side. These places, dumps like Hayaniya and

Jumhuriya, are much like the teeming Shia slums of Sadr City to the east of Baghdad. No one dares say they will not explode again.

The fear of that will increase if the new council fails to deliver services, as it may well do. Most Basrawis seem happy that the militias have been swept aside for the moment. Many, with a forced bravado, say the people will “never let them back”. But often in the same breath they say they are also nervous about what will happen when the Americans leave. Despite Britain’s last-gasp efforts to perk things up, Basra is still struggling to come back from the dead. For the British, their Iraqi venture cannot be marked down as glorious.

The Gaza Strip

Not nearly back to normal

Apr 30th 2009 | GAZA CITY
From The Economist print edition

Three months after Israel's war ended, life for Gazans is still dismal

AP

Do-it-yourself reconstruction

MUHAMMAD KHADER places some rugs and blankets amid the ruins of his house. Sometimes he goes there to rest when the tent he shares with his wife and six of their daughters gets too crowded. They ran away from their home earlier this year when it was hit by a missile during Israel's war in the Gaza Strip, and fled to their only married daughter's house in Jabaliya, a Palestinian refugee camp originally built for villagers fleeing in 1948 from what is now Israel. The daughter did not have enough blankets or mattresses for everyone but the neighbours helped out.

As soon as the Israeli troops pulled out of Gaza in mid-to-late January the Khader family went home—to find a pile of rubble. Even their chicken pen had been bulldozed. It had been their sole source of income since Mr Khader, along with thousands of other Gazan men, lost his permit to work in Israel after the second Palestinian *intifada* (uprising) started in 2000. Now he sits amid the debris and gazes at the green tents with Rotary International logos which an Arab charity has pitched on a muddy, desolate field on Jabaliya's eastern edge. Before the war, olive and citrus trees grew there. "We used to work in Israel," he says, lighting another cigarette. "We worked for them, built their houses. And now look what they've done to us."

Mr Khader is one of tens of thousands of Palestinians who became homeless in the recent Gaza war. UN agencies estimate that 4,100 houses were destroyed and 15,000-plus damaged; 50,000-odd people sought refuge in UN schools during the fighting. Most went home after the truce or found other places to live. But thousands are still huddling in tents in makeshift refugee camps.

A mining bulldozer noisily clears away the ruins on the fringe of Jabaliya but there is virtually no reconstruction anywhere in Gaza. At an international donors' conference in the Egyptian resort of Sharm el-Sheikh in March, $4.5 billion was pledged for reconstruction. But three months after the ceasefire, repair work has yet to begin.

Israel is still enforcing the sanctions it imposed on Gaza after the Palestinian Islamist movement, Hamas, took over the strip in June 2007, violently ousting its secular rival, Fatah. The Israelis still refuse to let in most imports except food and vital medicine. They still bar building material such as concrete, steel and pipes, as well as industrial equipment. They say they fear that Hamas and other militant groups would use them to build bunkers or weapons, such as the home-made rockets they still sometimes fire at nearby Israeli towns.

Supplies for repairing the water and sewage system and the electricity networks damaged during the war are also stuck at the border terminals. A good 90% of the people suffer from power cuts; the rest have no electricity at all. While 32,000 people in a population of 1.5m have no running water, 100,000 or so get water once in every two or three days. The United Nations Relief and Works Agency (UNRWA), which looks after Palestinian refugees across the Middle East, says that the rate of infectious diseases, including diarrhoea and viral hepatitis, which result from bad water and sanitation, has risen.

Commercial petrol and diesel fuel have not been let into Gaza since November, but the tunnels under the Egyptian border, which were a main target of Israel's bombs, were rapidly repaired; smuggling is

flourishing again. The Palestinian association for petrol-station owners says that 100,000 litres of diesel and 70,000 of petrol enter Gaza every day via the tunnels.

The canned broad beans which Mr Khader’s wife heats on a kerosene stove come from Egypt too. “Beans, beans,” sighs her husband. “How many beans can you eat?” It has been months since the family ate meat. The pitta bread they are given by an Islamic charity is their staple. Several of their girls are anaemic. “The doctor told me to give them better food,” says Mrs Khader, wiping tears off her face. “But what can I do? I cry every day.”

In the next-door tent, bitterness against Hamas is brewing. Many Gazans do not accept the party’s official view that the war was a great victory. Instead, many now blame Hamas for recklessly dragging them into a futile war that devastated their already beleaguered territory. “Where is Ismail Haniyeh?” cries a Gazan, referring to Hamas’s prime minister. “Why hasn’t he come here to see how we live? I lost my home. Why? For Hamas to succeed! It has destroyed Gaza. That’s a fact.”

Now Jabaliya’s homeless people seem to pin their hopes on a Palestinian unity government. If it were formed, they say Israel would be forced to lift its siege. But the rival parties have yet to make a reconciliation agreement stick, after nearly two years of fierce division.

Israel’s new government continues to link the ending of the blockade not only to the removal of Hamas as Gaza’s government but also to the release of Gilad Shalit, an abducted Israeli soldier who has spent nearly three years in captivity in Gaza. The new government sounds even less likely than the previous one to make the concessions, including the freeing of hundreds of Palestinian prisoners, that might clinch a deal. A Palestinian painter in Jabaliya has painted a mural of Corporal Shalit as a young man next to images of how he would look, grey and grizzled, after another 30 years in captivity. “If I saw Shalit,” says a Jabaliya resident, “I would just tell him to go back home to his country!”

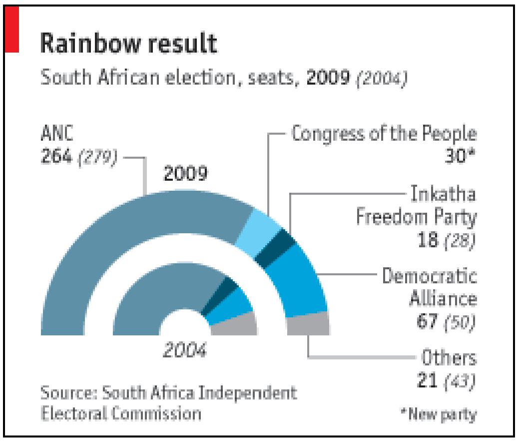
Until the border is open to trade and materials, it will be impossible to rebuild Gaza—or give its people a life approaching normality. “It makes you wonder what those donors’ pledges were worth”, says an UNRWA man in Gaza City.

South Africa's elections

A big win for a big new man

Apr 30th 2009 | JOHANNESBURG
From The Economist print edition

Jacob Zuma has proved his popularity; his party is unbeatable for now



DESPITE scandals, a leader dogged by allegations of corruption and the worst split in its ranks for nearly 50 years, the ruling African National Congress (ANC) chalked up another runaway victory in South Africa's general and provincial elections on April 22nd. Its share of the vote fell slightly, from 70% in 2004 to 66%, just shy of the two-thirds needed to change the constitution. But the ANC still won more votes than at any time since the first multiracial elections in 1994. It looks unassailable for a decade ahead.

It was certainly undented by the breakaway Congress of the People, initially regarded as the first serious challenge to it since it came to power. The new party, known as Cope, picked up just 7% of the vote, a far cry from the 30% it had at one point predicted and less than half the score of the white-dominated Democratic Alliance (DA), which is still the main national opposition. Though Cope pipped the DA in local elections in five of South Africa's nine provinces, it failed to make any big inroads into the ANC's vote. In the Eastern Cape, which it had hoped to win, it got only 14%.

Although Cope's leaders are trying to put a brave face on things, pointing out that the party will have 30 MPs in the 400-seat parliament, its future must be in doubt. Barely five months old, it lacked organisation and a clear strategy. It attacked the ANC for corruption, nepotism and arrogance, yet voters knew that Cope's leaders had long been prominent ANC people. It also wobbled in its attitude to Thabo Mbeki, whom Jacob Zuma's people had ousted from the ANC's presidency and then from the national one. Supporters of Cope sang (literally) Mr Mbeki's praises, yet Cope's leaders sought to distance themselves from him.

Furthermore, Cope was fishing in the same pond as the DA, among better-educated, middle-class people worried about their country's future under an all-powerful former liberation movement led by the untested, controversial and populist Mr Zuma. But whereas the black-led Cope attracted mainly black voters, the white-led DA appealed mostly to South Africa's whites, mixed-race coloureds and Indians, who together make up a fifth of the country's 49m-plus people.

Competition from Cope makes the DA's success all the more impressive. With 17% of the vote, it got 67 seats. It also broke the ANC's stranglehold over all nine provinces by winning the Western Cape—and with an absolute majority. Helen Zille, the DA leader and mayor of Cape Town, will now take over as provincial premier. Though the DA could rule the province alone, she may invite some smaller parties to join her. If the DA is to challenge the ANC at the national level, she knows it must attract black voters.

Mr Zuma's ANC did particularly well, as expected, in his own homeland of KwaZulu-Natal, where Mangosuthu Buthelezi's once-powerful Inkatha Freedom Party, which used to be locked in violent strife with the ANC, slumped from 37% in the last election in 2004 to 21% this time; nationally, the Zulu party has fallen steadily from 11% in 1994 to under 5% today, though it still won 18 seats.

No other national party reached 1% but a handful of tiddlers, thanks to South Africa's system of party lists and proportional representation, will together have about 20 seats in Parliament.

I'll put away my machinegun

Mr Zuma has hastened to reassure those who fear another five years of ANC dominance. There has been no hint of the threatening, vengeful tone that sometimes marked his campaign. Since the election, he has sounded statesmanlike and conciliatory. He felt “humbled and grateful” for his decisive mandate, he said, promising to defend the constitution and be a president for all South Africans. He says he will serve only one term.

Not everyone will be convinced by this sweet talk. Many are waiting to see whom he appoints as ministers and what his policies will be. He is due to be elected president by Parliament on May 6th, and will announce a new government after his inauguration three days later. But speculation is rife, especially concerning Trevor Manuel, South Africa’s steady finance minister. Some said he would head a new central planning commission in the presidency. The latest buzz is that Mr Zuma will keep him in his present post to reassure the markets.

Mr Zuma will outline his new government’s programme in a state-of-the-nation address on June 3rd. There will, he says, be “no surprises”. He will stick to the ANC’s election manifesto: more jobs, better education, less crime, more subsidised housing and more welfare. But with South Africa slipping into its first recession in 17 years, Mr Zuma will be hard put to fulfil all those promises. He has a rough road ahead.

Rebranding Nigeria

Good people, impossible mission

Apr 30th 2009 | LAGOS
From The Economist print edition

The government of a great nation tries a short cut to salvation

Illustration by Peter Schrank

A NEW joke is doing the rounds in Nigeria. Got a problem with your car, or your generator's stopped working? Don't fix it! Rebrand it! The grim humour reflects scepticism about a national rebranding campaign launched by the government to bring tourists and foreign investment to Nigeria, and generally to buff up the country's image. The campaign's slogan is "Nigeria: Good People, Great Nation".

The force behind it is Dora Akunyili, the new minister of information. She welcomes the fact that Nigerians are talking and even laughing about the rebranding. "It was not my intention but I am very happy it has generated these discussions, because they are very healthy for our democracy," she says.

Ms Akunyili made a name for herself as the campaigning head of the country's food and drug standards' agency. Her zealous pursuit of counterfeit medicines nearly earned her a bullet in the head, leaving instead a hole in her headdress. Aware of the cynicism, she says she will not spend any extra public money on the rebranding campaign. Instead, she has about $1m left over from the government's previous attempt to rebrand Nigeria which carried the slogan "Nigeria, Heart of Africa". She wants private business to meet the rest of the cost.

The previous exercise failed, and there is little reason to expect the latest one to do much better. Many Nigerians say their government should tackle the country's fundamental problems—power shortages, crime and corruption—before worrying about its image. "They [the government] have been sending texts to my phone, telling us about how to reorganise Nigeria, how to reorganise our minds, our heads," says Olufemi Oyegun, an oil-and-gas man in Lagos, the commercial capital. "But it's our leaders that are our main problem, not the people."

Fraud and corruption still scare businesses away from Nigeria, even though its market of 140m people is Africa's largest. In a recent report, ORC Worldwide, a consultancy, listed Lagos, with its violent crime, bad roads and wretched sanitation, as the world's worst place for expatriates to live in. A spot of rebranding is unlikely to wash away such awkward findings.

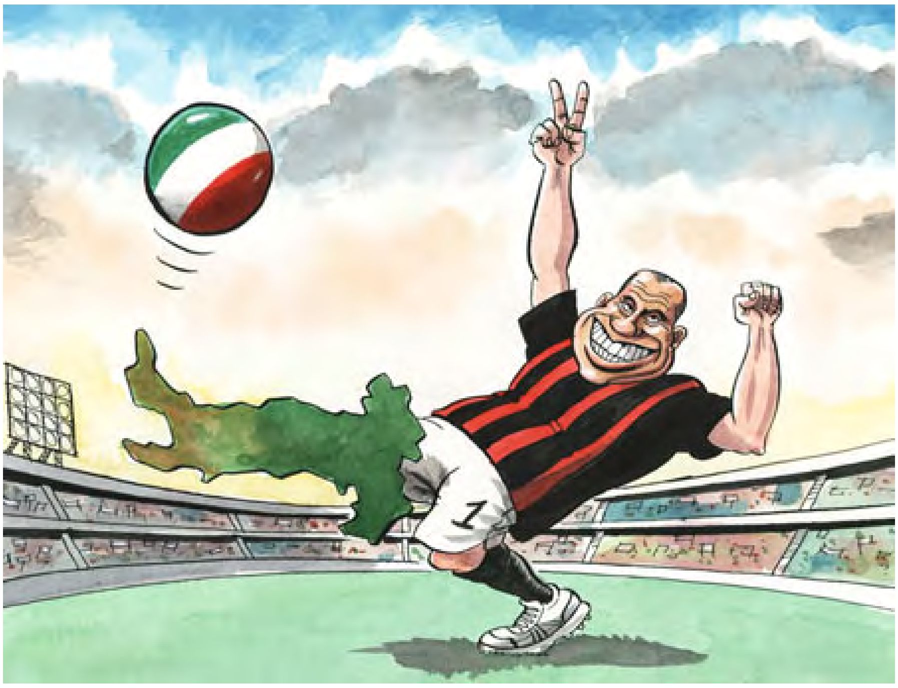
Italy and its prime minister

The Berlusconisation of Italy

Apr 30th 2009 | ROME
From The Economist print edition

The Italian prime minister seems more strongly entrenched than ever

Illustration by Peter Schrank



IF ANYBODY is having a good recession, it is the Italian prime minister, Silvio Berlusconi. Italy is certainly suffering: the IMF expects GDP to fall by 4.4% this year, a bigger drop than in Britain, France or Spain. But Mr Berlusconi remains significantly more popular than most other European leaders. His approval rating this month, measured by IPR Marketing for *La Repubblica*'s website, actually rose to 56%.

Part of the explanation is that, after more than a decade of underperformance relative to the European Union, Italians are used to economic distress. And since their banks were less enterprising (or reckless) than those in America and Britain, none has collapsed so far, sparing Mr Berlusconi the politically lethal fallout from using taxpayers' money to save the hides of rich financiers. Yet his approval rating had been slipping—until the earthquake that hit L'Aquila on April 6th.

Mr Berlusconi's response to the earthquake seems to explain the latest uptick. He spent almost a week in the disaster zone and even offered to accommodate some survivors in his own homes. On April 23rd he went a daring step further, saying he would switch the venue of the G8 rich-country summit in July to L'Aquila, partly so as to divert funds towards the city's reconstruction. On the same day he announced a seemingly generous €8 billion ($10 billion) in aid for the earthquake zone (it has since emerged that this will be spread over no less than 22 years).

Mr Berlusconi's response to the earthquake highlights another factor that his supporters claim explains his poll ratings. As one minister puts it, "this is the first government since the second world war to give Italians decisive leadership of a kind that is entirely normal in Europe." That contrasts with his previous period in power in 2001-06, when he had to deal with repeated internal revolts. Many were caused by the centrist Union of Christian Democrats, which split from the centre-right coalition before the April 2008 election that returned the right to power.

Mr Berlusconi's present government is far more homogenous. In March its two biggest components—his own Forza Italia and the National Alliance, which grew out of the neo-fascist movement—united in a single entity, the People of Freedom. Of the two other coalition parties, only the Northern League has the

parliamentary clout to bring the government down.

To Mr Berlusconi's critics, the explanation of his popularity is quite different. It is that he is reaping the benefit of a long-term influence on the views of his compatriots that no contemporary politician can rival. Every Italian under 30 has grown to political maturity in a country where Mr Berlusconi and his family control half the television output, one of four national newspapers, one of two news magazines and the biggest publishing house.

His hold on the media has changed attitudes and even the meaning of words. When he entered politics in 1994, few gave credence to his claim to be a victim of conniving communist judges; now it is widely believed. Fifteen years ago, an *azzurro* represented Italy in international sporting competitions and a *moderato* was a centrist. Today, an *azzurro* is somebody who represents Mr Berlusconi in parliament; a *moderato* anybody who votes for him.

The subtle Berlusconisation of Italy may help to explain a trend that has swept the country in the past 12 months. It is not only that the opposition has divided and the unions are split. It is that a conviction has gripped much of society that the prime minister will stay in power indefinitely. "I have to say that I see no alternative to Silvio Berlusconi," declared Gabriele Muccino, a film director and one of several intellectuals and artists who have recently voiced similar opinions. This is ironic in a country whose politicians spent 15 years working towards a two-party system. It augurs ill for future economic reforms, in which Mr Berlusconi has shown little interest. And it is also troubling in any democracy, especially when seen in the context of the prime minister's own words and actions.

His new party is as undemocratic in its form as Forza Italia was. He was acclaimed, not elected, leader at a founding congress last month that empowered him to appoint the executive. Mr Berlusconi routinely denigrates the judiciary and, since returning to power, has become increasingly dismissive of the legislature as well. His government's use of procedural devices to cut short parliamentary debate has even been criticised by his ally, Gianfranco Fini, former leader of the National Alliance and now speaker of the lower-house Chamber of Deputies. Mr Berlusconi has sought to justify this by arguing that the myriad checks and balances in the system make Italy ungovernable. But, as President Giorgio Napolitano retorted recently, such views pointed to "authoritarian solutions". After all, the system was put in place precisely to prevent the return of a dictator like Benito Mussolini.

Few believe that there is a serious risk of reverting to those dark days. But several recent books have highlighted the extent of Mr Berlusconi's ascendancy and asked questions about how he intends to exploit it. Massimo Giannini, author of one, argues that his aim is "not a dictatorship in the classic sense, but…a modern form of post-ideological 'totalitarianism'".

The most powerful reason to worry comes in Mr Berlusconi's own words. At his new party's inaugural congress, he reminded the 6,000 or so delegates that "sovereignty belongs to the people". But he also claimed that his was "the only party that defines the identity of our people". In fact, he said, "we have to be a people even more than a party". That smacks of pure populism.

Mr Berlusconi's supporters dismiss all such misgivings, insisting that his sole long-term objective is the presidency (albeit, perhaps, after a constitutional reform to make it more powerful). On April 25th, the day when Italians mark the 1945 Allied liberation, the prime minister offered support for the view that he aspires to lead the nation, not just the right. He took part for the first time in the celebrations. Later he withdrew a controversial bill that would have given honours and pensions to Mussolini's diehard militia.

But Mr Berlusconi also took the opportunity to suggest that the name of the holiday should be changed. It should not be the day of liberation but of freedom. As in, for example, the People of Freedom?

Iceland's election

Visions of Johanna

Apr 30th 2009 | REYKJAVIK
From The Economist print edition

There may still be many a slip before Iceland joins the European Union

AFP

Long haul for a former air hostess

THE Social Democrats emerged as the big winners of Iceland's election on April 26th. Their coalition partner, the Left Greens, also did well. The big loser was the Independence Party, which for the first time in 18 years will not be in government. The prime minister will be Johanna Sigurdardottir, an openly gay former air hostess who has held the job in an acting capacity since the previous government gave up in January.

Iceland's voters seem to want politicians who are largely untainted by the country's grave economic crisis. The *Kreppa*, as it is known, will continue to dominate the political agenda even though over six months have elapsed since the government took control of the big banks, brought in the IMF and imposed strict exchange controls. GDP is likely to shrink by 10% this year. Half the country's businesses are technically insolvent; some 15% of Icelanders are in negative equity. More foreclosures look inevitable; the three big banks are unlikely to survive in their current form.

The government has yet to finalise all of the terms of its $2.1 billion loan from the IMF, pending an audit of the banks and its own budget. Negotiations with the British and Dutch governments over repayment of the $5.8 billion still owed in respect of Landsbanki's Icesave depositors are deadlocked. The projected debt from the IMF and Scandinavian rescues, combined with Icesave's obligations, will exceed $11.1 billion, roughly equal to Iceland's GDP in 2007. So the budget, when finally presented, is likely to contain some swingeing spending cuts and tax rises.

The Social Democrats' election victory owed much to their commitment to apply for membership of the European Union as soon as June. They presented the EU and early euro membership as a panacea for Iceland's ills. Yet the process may not turn out to be smooth. Ms Sigurdardottir's Left Green coalition partner is essentially Eurosceptic, preferring to pursue closer commercial links with Iceland's Nordic partners. And although Iceland, as a member of the European Economic Area, already applies most EU laws, negotiations over fisheries, which Iceland manages well but the EU does not, could derail its future membership.

One political answer might be to return to the ballot boxes, by holding a referendum to approve an application to join the EU. The government would also promise another referendum on the terms of entry. Given the painful fiscal outlook, and worries over fish, there is no guarantee that both or even either of these votes will be won.

Turkey and Armenia

Mountain chess

Apr 30th 2009 | ANKARA AND YEREVAN
From The Economist print edition

Recent moves towards a peace deal may come unstuck

A HIGH-STAKES chess game is being played out in the south Caucasus. It involves America, Armenia, Azerbaijan, Russia and Turkey. Unlike chess-players, though, all the participants can win in this game, it is hoped, if they agree on a common aim: peace between Turkey and Armenia, which would help to thaw the frozen conflict between Armenia and Azerbaijan over the (mainly Armenian) territory of Nagorno-Karabakh.

It almost seemed possible on April 23rd, when Turkey and Armenia declared that they had agreed on a “road map” to establish formal ties and reopen the border. This was sealed by Turkey in 1993 to show solidarity with Azerbaijan, which had just lost 20% of its territory, including Nagorno-Karabakh. If the border were open, Armenians could then climb their sacred Mount Ararat. Friendship with Armenia might give Turkey the muscle to push through a deal on Karabakh, as well as securing it a bigger role in the south Caucasus. And that would give Turkey’s friends a fresh reason to promote Turkish membership of the European Union.

The most immediate benefit, though, was meant to be dissuading Barack Obama from keeping his campaign promise to call the mass slaughter of Ottoman Armenians in 1915 “genocide”. In the statement he issued on April 24th, the day when the world’s Armenians commemorate the tragedy, the American president tried to please everybody. He plumped for “*medz yeghern*”, Armenian for “great catastrophe”. (Cynics noted that the Turkish- Armenian deal, though initialled a month ago, had been announced only a day earlier.) And he praised Turkey’s and Armenia’s peacemaking efforts. Hardliners in Armenia and the diaspora were furious, accusing Mr Obama of reneging on his promise. Yet in Turkey the opposition complained that he had simply swapped Armenian for English to say the same thing.

A bigger obstacle to a deal may be Azerbaijan. It is threatening to turn towards Russia and to increase the price of the natural gas it sells to Turkey. This may explain why the Turkish prime minister, Recep Tayyip Erdogan, has reverted to the traditional line that, unless Armenia makes peace with Azerbaijan, Turkey will not make peace with Armenia—even though the text they initialled reportedly does not mention Nagorno-Karabakh at all.

Some say he is posturing, to force Armenia to withdraw from some of the seven regions of Azerbaijan that it occupies outside Nagorno-Karabakh. Azerbaijan’s president, Ilham Aliev, and his Armenian counterpart, Serzh Sargsyan, are due to meet in Prague next week, before an EU eastern-partnership summit. But Mr Sargsyan, whose image was marred by a disputed presidential election in April 2008, is unlikely to bend further. One admittedly puny coalition partner has already walked out over the deal with Turkey. The financial crisis is starting to bite, too. Armenian migrant labourers are returning from Russia in droves. Oil and gas prices have shot up. The Armenian dram has lost over a third of its value against the dollar.

The real spoiler may turn out to be Russia. Armenia is the only country bordering Turkey, a NATO member, in which the Russians have troops and a base. Peace with Turkey could lead to their withdrawal, as Armenia leans westward. The trade-off, say some, could be for Russian peacekeepers to defend the corridor linking Armenia proper to Nagorno-Karabakh. But Russia is also said to be bullying Azerbaijan for more gas. If it gets it, that may kill the planned Nabucco pipeline to carry Central Asian and Azerbaijani gas to Europe via Turkey, leaving Europe more dependent on Russia for its energy.

Portugal's economy

Socratic dialogue

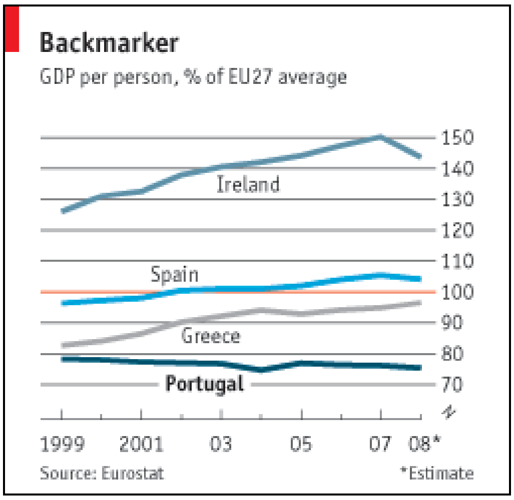
Apr 30th 2009 | LISBON
From The Economist print edition

A lousy economy, glum voters—yet the prime minister may still win in October

THE Portuguese are among the glummest people in Europe. According to a Eurobarometer poll, 92% see the economic situation as bad; fully 95% are depressed about their job prospects; and over half are “dissatisfied with the life they lead”. Within the European Union, only easterners from Hungary and Bulgaria are similarly morose. Why the pessimism?

José Sócrates, the Socialist prime minister, could offer reasons to be more cheerful. Portugal has not experienced a big property bust like those in Spain and Ireland. Its exporters are tapping into new markets, particularly Angola and Brazil. Angola, where GDP is growing at close to 10% a year, is now Portugal’s fourth-biggest export market. By avoiding most toxic assets, the banks have stayed relatively sound. And by pushing renewable energy, the government has made Portugal a model of how to stimulate the economy and fight climate change. Investments worth €14 billion ($18 billion) will create 22,000 jobs by 2020, by which time Portugal will produce over 60% of its electricity from clean energy, way above the EU target of 20%.

Yet it is hard to cheer people with such arguments when overall economic performance has been so poor. This year GDP is expected to contract by 3.5%, lifting unemployment to about 8.5%. These are hardly cheering figures, but the real problem is that they come after a decade of below-average growth. GDP per head has fallen from almost 80% of the EU average ten years ago to just 75% in 2008. Far from catching up, Portugal has fallen further behind—unlike others in the EU (see chart).



Part of the problem was that joining the euro in 1999 pushed interest rates too low. The Portuguese borrowed heavily to buy houses, cars and airline tickets. Easy credit and rising wages sucked in imports, swelling the current-account deficit to 12% of GDP last year. Productivity failed to keep up. Instead of compensating for a limited domestic market, exports have remained stubbornly stuck at 30% of GDP—less than in most comparable small EU countries.

To improve its performance, Portugal needs more flexible labour laws, less bureaucracy, a better educated workforce, more competition and a smaller state. As the IMF states in a recent report, the country’s fundamental problems are domestic, not global, in nature. But political leaders find reforms hard to push through. Despite this, Mr Sócrates may well win the election due in October, even if the Socialists lose their absolute majority.

The prime minister has his own reasons to be less than cheerful, however. In what he calls a “black campaign of selected and manipulated leaks” designed to damage his electoral chances, the media have spent months looking into a supposed corruption scandal over the approval of a new shopping centre in 2002, when Mr Sócrates was environment minister. Mr Sócrates denies any wrongdoing; the judicial authorities have said no politician is involved. But the fact that an investigation begun in 2005 is still going shows the inefficiencies and delays of the judicial system, another failing that harms competitiveness, deters foreign investment—and leaves the Portuguese despondent.

French universities

One out, a quarter out

Apr 30th 2009 | NANTERRE
From The Economist print edition

Few have noticed, but strikes have closed a lot of France's universities

"THE university is going up in smoke," says a handwritten banner strung from a tree at the entrance to the University of Nanterre, near Paris. On the ground, a brazier is indeed burning. A cluster of students brandish bright pink flares. In the social-science tower block, where posters promote Olivier Besancenot's New Anti-Capitalist Party, others have stacked piles of desks and chairs in the entrance hall, in a bid to make teaching impossible.

Militant workers who kidnap their bosses and big union-led protests of the sort planned for May 1st may hog the headlines. But a less visible battle has been disrupting as many as 20 of France's 83 universities—including the Sorbonne—for over two months. Campuses have been blocked by strikes. In certain subjects, particularly the social sciences, lectures have been cancelled altogether, leaving students unsure whether they will be able to take their end-of-year exams.

The protests, by both students and lecturers, are ostensibly against higher-education reforms that grant more autonomy to universities. Lecturers object to new rules that impose regular performance evaluations and give more powers to university presidents to manage, promote and pay staff. Although there are neither tuition fees nor selection at entry, students are against any hint of competition and what they call the "privatisation" of universities, which can now raise private money. They fear the creation of a two-tier system, with worthless degrees for those at "dustbin universities". Researchers particularly mistrust President Nicolas Sarkozy, who mocked their output early this year and who likes to deride French intellectuals. A previous bid to reform the rules for lecturers and researchers was withdrawn only after fierce resistance.

Valérie Pécresse, the higher-education minister, says that university exams will be postponed to the summer holidays if necessary, to allow time for extra classes. "There will be no discount degrees," awarded due to half-cancelled courses, she promises. A few lecturers have been improvising to catch up. On sunny days, some at Nanterre have taught outside on the grass. One enterprising teacher at a university in Avignon held a statistics exam in a local McDonald's restaurant, though it was invalidated by the administration.

In truth, many students are fed up with the disruption. Marc Gontard, president of Rennes II, one of the most strike-hit universities, says that those actively trying to block faculties are a small minority, led by hard-left elements. Others dream of reliving the student uprising of May 1968, sparked off when students occupied a building on the campus at Nanterre, earning it the nickname "Nanterre the red". "They feel they have a reputation to live up to," comments a security official at Nanterre, coolly watching the protesters. He notes that these would-be revolutionaries have thoughtfully brought along two fire extinguishers, just in case. It is a mark of how regular disruption has become that students streaming in from the nearby station scarcely turn their eyes to see their peers protesting and burning flares.

There are signs that student disruption at some universities is starting to have unintended consequences. The most radical campuses, including Rennes II, Toulouse II-Le Mirail and Lille III, have recently seen falling enrolment. Between 2004 and 2007, according to research by the National Inter-University Union, a centre-right student association, enrolment at the 11 most strike-prone universities fell three to five times faster than the national average. In more ways than one, it seems, French students are voting with their feet.

The Roma in eastern Europe

Canada home and dry

Apr 30th 2009 | PRAGUE
From The Economist print edition

How Roma fleeing persecution win asylum in Canada

AP

Looking over the fence to Canada

EMIGRATION to Canada was a well-trodden road for dissidents after the Soviet-led invasion of Czechoslovakia in 1968. It is 20 years since the country's leaden communist regime perished in the velvet revolution. The Czech Republic is a regional success story. Yet rising numbers of Roma (gypsy) citizens are making the same journey to the same faraway country, because life at home is intolerable.

Around 250,000 Roma live in the Czech Republic. Their problems include poverty, lack of education, centuries of prejudice and, now, attacks by far-right extremists. According to the Canadian embassy in Prague, 861 Czechs applied for asylum in Canada in 2008, and 84 won it. Canada does not record their ethnic origin, but officials say most were Roma. That exceeds figures from countries such as Afghanistan (488 applicants) and Iraq (282). For communist Cuba, much scolded by the Czech government for its poor human-rights record, the figures were 184 applicants and 93 given asylum. The numbers for the first quarter of 2009 are even more startling: 653 applications, of which 34 were granted.

Admittedly, getting to Canada is easier for the Czech Roma than for Afghans or Iraqis (in October 2007 the Canadians lifted visa requirements for Czechs that had been imposed ten years earlier after a previous Roma exodus). But the figures are also higher than from other ex-communist countries with large Roma populations and visa-free travel to Canada. Last year only 288 Hungarians made applications, with 22 granted.

Some Canadian officials say asylum has become a business, with middlemen charging Roma to arrange it. But nobody has produced evidence of this, and the Czech authorities say they have seen no sign. Anna Polakova, who heads Romani-language public broadcasting in Prague, says the claims are absurd. She also questions the idea that Roma asylum applicants are motivated by Canadian welfare payments. “Even if you have little, your family has been here for two, three generations. You know the language. We have our graves here,” she says. In her view, it is middle-class Roma who are leaving in frustration. “Despite all the talk, the fascists are walking down the street.” She herself considered emigration after her son was badly beaten up by skinheads.

The Czech record is no source of pride. Not only has far-right extremism been rising, but so also is segregation. A government study in 2006 found that 80,000 Roma live in over 300 ghetto-like communities, four-fifths of which came into existence only in the previous decade. Roma activists blame Jiri Cunek, a Christian Democratic leader and former deputy prime minister, for making anti-Roma prejudice acceptable in mainstream politics. A mayor of Vsetin in the east, Mr Cunek ordered the eviction of dozens of Roma families from a run-down building in the town centre into containers on its edge.

Recently police blocked a confrontation between Roma activists and a neo-Nazi march in Krupka, in the north-west. Last November a similar event in Litvinov, in the north, turned into a riot, with police fighting 500 right-wingers trying to get to a Roma neighbourhood blamed as a hotbed of crime. A firebomb attack

on a Roma dwelling in Vitkov, one of three in recent months, badly burnt a 22-month-old girl.

Roma are suffering in many other countries in the region. Hungary has witnessed a spate of especially nasty murders. But the rich, well-governed Czech Republic, which holds the European Union’s rotating presidency, can surely do better.

Charlemagne

Those selfish Germans

Apr 30th 2009
From The Economist print edition

As Germany becomes “normal”, it looks a bit more national and a bit less European

Illustration by Peter Schrank

ON MAY 1st ten countries celebrate their fifth birthday as members of the European Union. It ought to be quite a party: the enlargement of 2004 to take in countries like Poland and Hungary marked a rare moment of strategic wisdom. Alas, the anniversary has already been overshadowed by an act of petty selfishness on the part of Germany.

The German government announced this week that it was keeping labour restrictions on workers from the eight east European countries that joined in 2004 (the other two new members, Cyprus and Malta, were tiddlers that escaped the restrictions). The controls were meant to fall away in 2009, but Germany invoked a clause allowing two more years in case of “serious labour-market disturbances”, or the threat of them. The idea that free movement by Poles or Slovaks would threaten “serious” disruption is nonsense. Germany still has shortages of skilled labour in some areas, and it hardly looks like El Dorado to hordes of unskilled migrants: the latest forecast is that the economy will shrink by 6% this year. The decision to keep labour controls is purely political. Germany faces elections to the European Parliament in June and a national poll in the autumn.

Only one other country, Austria, still keeps its labour market closed to the 2004 entrants. But nobody ever accused Austria of being visionary. Germany is meant to be different. More than any other country, it made EU expansion possible. As the union’s biggest paymaster, Germany agreed to foot the lion’s share of the bill. And it was the Germans who persuaded the reluctant French to expand the club. So is Germany now a “normal” (ie, selfish) country, more attuned to national than to European interests? That is a fashionable charge among federalists. As an example, they criticise the German chancellor, Angela Merkel, for her timid response to the economic crisis, for vetoing a common European fund to bail out banks and for resisting a joint EU stimulus.

Ms Merkel is from the Christian Democratic Union (CDU), but her grand-coalition partner, the Social Democratic Party (SPD), also disappoints pro-Europeans. The SPD finance minister, Peer Steinbrück, spent months calling the economic crisis an “American problem”. Although he has conceded that euro-area countries might be bailed out before they go bust, he will not be drawn on how. Prominent federalists like Joschka Fischer, a former German foreign minister, have called on Germany to support joint euro-area bonds, though these might damage the country’s own high credit rating. Other examples offered by insiders include a European food bank for the poor, mooted at one summit. The SPD foreign minister,

Frank-Walter Steinmeier, who will stand against Ms Merkel this autumn, shot the idea down, saying that each country should “take care of its own poor”.

One senior European politician comments that federalists have short memories. The true turning-point for Germany was 1998, he says, when Gerhard Schröder defeated the CDU’s Helmut Kohl for the chancellorship. During his campaign, Mr Schröder accused Mr Kohl of putting European interests ahead of German ones. He had a point: Mr Kohl pushed through the single currency even though most German voters opposed it, and nasty EU rows about money usually ended with Mr Kohl pulling out Germany’s chequebook. Mr Schröder was less community-minded, happy to shout, “Germany is not paying for this one,” at summits. It was under Mr Schröder that Germany began its quest for a permanent seat on the UN Security Council, after years of seeking a single place for the EU.

Today the picture is mixed. Ms Merkel is less impatient at EU summits than Mr Schröder. But, unlike Mr Kohl, she brings no retinue of smaller countries as allies to every meeting. And despite the recent display of Franco-German unity at the G20 gathering in London, she neither trusts nor likes France’s Nicolas Sarkozy.

In search of German logic

Germany’s closed labour market may look like a detail amid global economic turmoil. But it matters. It represents a surrender to populist introspection and a betrayal of the logic of Europe’s open borders. That is a shame, as Germany has stood up for free trade and the EU’s internal market in other fields, slapping down protectionist proposals from France and taking it on the chin when domestic stimulus schemes like its car-scrapping bonus sucked in cars made in eastern Europe.

The labour restrictions are in truth a symptom of a deeper malaise. Tensions within the grand coalition define “everything” in EU affairs, complains a minister from a neighbouring country. Another sighs that “what we see now in Germany is less and less one government, and more and more two parties”.

This is perverting otherwise sound initiatives. At a foreign ministers’ meeting on April 27th, Germany sounded the alarm about instability in Ukraine, on the EU’s eastern border. German diplomats say privately that Russia is playing alarming games by issuing passports to Ukrainian citizens. Germany wants the EU to consider such steps as opening an EU office in Crimea, a part of Ukraine some Russian nationalists covet, or asking Russia to recognise Ukrainian territorial integrity. Coming from German diplomats, this amounts to welcome realism. But, notes an EU minister, concrete action to anchor Ukraine to the West and to Europe is limited by tensions in Berlin. The (CDU) interior minister will not hear of looser visa rules for Ukrainians as a carrot for good behaviour. The (SPD) finance minister opposes spending German money to prop up Ukraine’s economy.

Germany is not about to turn away from Europe. One senior figure concedes that the labour restrictions respond to “fears that are not so logical”. That is not good enough. Europe needs a bit of German logic to function. So does Germany.

Economist.com / blogs / charlemagne

The Conservatives in government

A cold coming they'll have of it

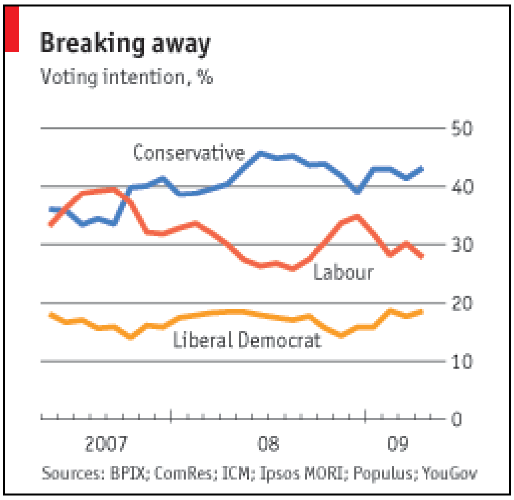
Apr 30th 2009 | CHELTENHAM
From The Economist print edition

The Tories, favourites for the next election, embrace austerity

The Guardian

FAMOUS for its top girls' boarding school and a racecourse beloved of preposterously hatted blue-bloods, Cheltenham is the kind of town where the recession seems a small war in a distant country. The timing of the Conservatives' recent spring conference there was as congenial as its setting: at most 13 months remain before a general election that, judging by the polls (see chart), will end the Tories' prolonged absence from power.

Yet the flatness of the jamboree, where activists were subdued, party staff glad to be absent and the speeches of ministers-in-waiting mostly leaden, almost drove observers to check that they had come to the right place. For David Cameron, the "heir to Blair" who has led the Tories to electability over the past three years, the contrast with Labour's beatific run-up to its 1997 election triumph must grate.



Much of this reflects Britain's grim *Zeitgeist*. Tories know that recession and the rise of anti-politics, stoked by stories of Westminster sleaze, means that loathing for the government does not imply love for its opponents. But some of the Cheltenham glumness reflects a dawning awareness that the next government faces a hard and unpopular slog, dominated by the burden of fixing the awful public finances.

The credit crunch and broader crisis that began in 2007 has often wrong-footed the Tories. Not only were they unconvincing on many specifics (they initially opposed the nationalisation of Northern Rock, a failed mortgage lender, for example), but Mr Cameron's thriving attempt to rebrand the party as sunny and youthful suddenly jarred with the bleaker times. Lulled like many by years of uninterrupted economic expansion, he took a while to shed a complacently post-economic message which vaunted "GWB", or general well-being, above GDP and suggested that society needed more fixing than the economy. The Tories persisted with their mantra of "sharing the proceeds of growth" between tax cuts and public spending after growth had stopped.

But the recession has discombobulated both main parties. Gordon Brown, despite a dead-cat bounce after his bank bail-out and fiscal stimulus last year, has seen his premiership mauled by it. (The Liberal Democrats' deputy leader, Vince Cable, has sounded authoritative but his party has made only slim gains in the polls.)

The Conservatives are now deftly re-re-branding themselves as the party of austerity. Their opposition to a debt-financed fiscal stimulus, and particularly to a temporary cut in VAT (a sales tax), seemed quixotic last autumn. It has since gained adherents, even before the mortifying scale of public borrowing was set out in the recent budget. To the frustration of their core supporters, the Tories have not promised to reverse the government's income-tax hike for high earners. The priority, says George Osborne, the shadow chancellor of the exchequer, is to undo the planned increase in national-insurance contributions. Taxes may have to go up, he thinks, but increasing those on jobs could kill an economic recovery before it begins.

Some in the party grumble that pundits have been slow to credit the Tories with taking brave positions on the economy. They console themselves that the public seems more impressed. A recent ICM poll showed Mr Cameron and Mr Osborne leading their opposite numbers in government on the question of economic competence by a ten-point margin.

None of this is to deny that the Conservatives have some way to go before their voice on economic matters truly carries. Their pledge to scrap inheritance tax for most households, so popular when it was unveiled in 2007 that it helped make Mr Brown retreat from a snap election he was about to call, now seems indulgent. The Tories have implied that implementing the policy may be delayed; it might make sense to scale it down too (it would raise the individual inheritance tax threshold from £325,000 to £1m, or $1.5m). Nor are they providing details about their approach to fiscal retrenchment. That is understandable: Mr Osborne reminds critics that, had he given in to demands for more precise plans in happier years, he would now be tearing them up. But fine print on which taxes are to rise and which budgets are to be cut will be expected eventually.

There are reasons other than the state of the economy to think that the Tories are shaping up to be sober rather than spectacular. Despite his self-styled affinity with Tony Blair, Mr Cameron has none of the former prime minister's messianic zeal. In his scepticism towards grand plans, and in the privileged background he shares with many colleagues (a political handicap, confess Tories too canny to believe Britain has become classless), he seems to follow more naturally in the tradition of patrician Tory leaders such as Harold Macmillan. His cautious line on health care, which some say is too soft on doctors and nurses, encourages this view, as does his rejection of a big-picture vision of foreign policy in favour of case-by-case pragmatism.

Not just Supermac's heir

But this tells only half the tale. Mr Cameron harbours some radical ideas, such as greater choice and competition among schools (see article) and the revival of local government. The theme of "giving power away" seems a neat response to plummeting trust in national politics. And Mr Blair, like Margaret Thatcher, acquired much of his boldness in office; Mr Cameron may do the same. Above all, austerity is its own form of radicalism. Efficiency gains alone will not plug the hole in the budget (see article); the government may have to shed functions altogether. Mooted ideas include limiting eligibility for tax credits, child benefit and other goodies to the poor and, because cuts will have to fall on Tory causes too, perhaps scrapping some defence projects.

Not the soporific "do-nothings" of caricature, then, but the Tories have greater expectations than that to live up to. Mr Osborne is confident that the next election will be as seminal as those of 1945, which led to the construction of the welfare state, and 1979, when free-market economics made its comeback. Bold stuff, but he has yet to outline what profound change in Britain's political economy he foresees.

Others outside Britain have high hopes of the Tories too. As centre-right leaders elsewhere wobble or fall, many conservative-minded observers may look to a new Tory government for inspiration. Some Tories were giddy recently when their favourite American pundit, David Brooks of the *New York Times*, cited Mr Cameron's communitarian strain of conservatism—or "Red Toryism", in the coinage of Phillip Blond, an intellectual fellow traveller—as the future direction for America's Republican Party. But this too needs elaboration if it is not to fizzle out like Mr Blair's "Third Way". What Britain's government will look like by the middle of next year is increasingly clear. What the country will look like five years after that is less so.

Public finances

Unpalatable choices

Apr 30th 2009
From The Economist print edition

It is hard to see how the Tories can avoid putting taxes up

THE fiscal shambles awaiting the next government is so bloody that the Conservatives could be forgiven for wondering whether they really want to win the general election, due no later than June 2010. It also casts doubt on whether George Osborne will in fact be able to fill the gaping hole in the public finances through lower spending rather than higher taxes, as he would prefer to do.

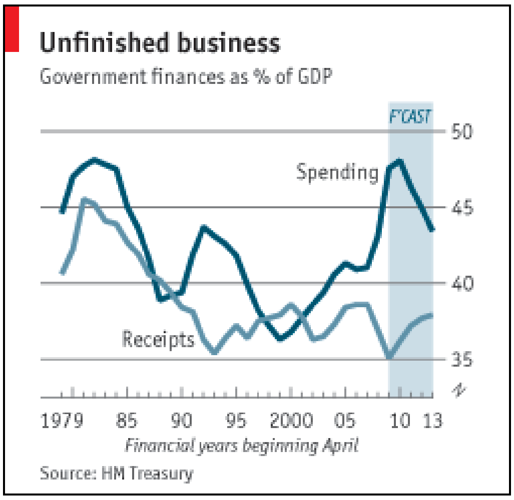
The problem the shadow chancellor of the exchequer faces is that Alistair Darling has got there first. Despite his tax raid on the rich revealed in the budget on April 22nd, the chancellor is relying mainly on spending curbs to start mending the public finances once the recession is over.

The particular sting for the Tories is that his plan is harsh yet inadequate. It envisages freezing spending in real terms for the three fiscal years starting in 2011-12. Yet this will still leave the budget deficit in 2013-14 far too high at 5.5% of GDP.

Making matters worse, the overall freeze will involve painful cuts for the public services voters care about. This is because the Treasury will have to fork out more money on other things, such as higher welfare costs and the sharply rising interest bill on the extra debt it is piling up. Making an educated guess at the resulting squeeze elsewhere, the Institute for Fiscal Studies (IFS), a think-tank, has worked out that it would entail the biggest cuts since those in the late 1970s following the IMF bail-out. The budgets of the departments responsible for public services, which swallow nearly 60% of total expenditure, will have to contract by 2.3% a year in real terms between 2011-12 and 2013-14, estimates Gemma Tetlow of the IFS.

Undertaking a still tighter squeeze is not as implausible as it might seem, since it would follow a long stretch of extraordinary largesse for the public services under Labour. After an initial period of restraint when he was at the Treasury, Gordon Brown opened the spigots. He presided over a prolonged splurge on spending, which rose sharply as a share of a pretty buoyant economy (see chart). It is now expected to peak at an astonishing 48% of national output in 2010-11. The Treasury then projects a reversal as Mr Darling's curbs bite and the recovery strengthens, but spending will still be 43% of GDP in 2013-14.

If Mr Osborne wants to get spending down further he will have to resort to more drastic measures such as tackling public-sector pay, which makes up a quarter of total spending. A survey published on April 27th by the British Chambers of Commerce found that 58% of companies were planning to offer no pay increases this year and 12% intended cutting wages. Two days later Miles Templeman, director-general of the Institute of Directors, called for a one-year freeze in public-sector pay. An incoming Tory government could insist on a longer freeze, forcing public employers to work out whether they need so many staff.



If the Tories lack the stomach for such measures, they will have to swallow their pride and raise taxes. This would be particularly awkward for Mr Osborne, since he wants to reverse Labour's planned half-point rise in the rate of national-insurance contributions. That may be a tax on jobs, as he says, but doing without it would cost the exchequer £5 billion ($7.4 billion) a year from 2011-12.

The budget, for all its faults, sent a clear message. If the public finances are to be sorted out in the next parliament, either further cuts in spending or increases in taxation will be necessary. More likely still is some combination of the two. Mr Darling's hopes for gazelle-like growth from 2011 look fanciful for an

economy emerging from such a grave financial crisis. Given this risk, borrowing may well subside less than the Treasury is projecting. The task that Mr Osborne is likely to confront could scarcely be more thankless.

The London bombings

Lost among the rubble

Apr 30th 2009
From The Economist print edition

The real plotters of the terrorist attacks may never be brought to justice

IT WAS not long after the bombs exploded on July 7th 2005 that police discovered the identities of the men who had carried and detonated them. But the four British Islamists who murdered 52 people on London's public transport network killed themselves in the process. Nearly four years on, no one has been convicted for the crimes, though police suspect that perhaps 20 people were in on it. A trial on which officers had pinned their last hopes of a conviction ended on April 28th with all three defendants acquitted of any role in the plot. Officers now doubt anyone will ever be sent down for the atrocity.

The case against Waheed Ali, Sadeer Saleem and Mohammed Shakil rested on their apparently close relationship with the July 7th bombers. They lived in the same part of Leeds and left DNA and fingerprints in the flat where the bombs were assembled. They had been to militant training camps in Pakistan; Mr Ali had served with the Taliban in Afghanistan alongside Mohammad Sidique Khan, the leader of the suicide attack. In court, Mr Ali boasted that he was willing to fight abroad, and against British soldiers.

All three men visited London in late 2004 along with two of the eventual bombers, in what prosecutors claimed was a reconnaissance mission. Mobile-phone records showed that they had been near the King's Cross, Edgware Road and Aldgate East Underground stations, three of the eventual targets. The defendants said the reason for the trip was to let Mr Ali say goodbye to his sister before he travelled to Afghanistan. Jurors gave them the benefit of the doubt, though they did find Mr Ali and Mr Shakil guilty of conspiring to receive terrorist training, for which each was jailed for seven years.

The government has resisted calls for an independent inquiry into the terrorist attack and its investigation, arguing that it would tie up the security services at a time when they are needed on the front line. But a report from the parliamentary committee on intelligence and security, to be published in May, could highlight mistakes made by the security services, without which the bombers might have been intercepted before the attack. West Yorkshire police supposedly failed to follow up a request by MI5, Britain's domestic spying agency, for information on Khan, whom they had spotted during surveillance of Omar Khyam. Mr Khyam was convicted in 2007 for his part in a plot to set off a bomb in a nightclub or a shopping centre. The report will also amplify questions about why police did not act sooner: Khan had been noted and followed by secret-service agents more than a year before July 7th.

That will be hard to take, for officers are under fire elsewhere for acting precipitately. Last month 12 people, 11 of them Pakistanis, were arrested in connection with what police said was a "very, very big" terrorist plot. After all were released without charge, police were criticised for acting before the alleged plotters had incriminated themselves enough for a conviction.

Back in Leeds, detectives are certain that people are withholding information about those who helped to set up the July 7th attack. Several sets of fingerprints in the bomb factory remain unidentified.

Settlement rights for soldiers

Gurkhas v government

Apr 30th 2009
From The Economist print edition

Guess who won?

THEY have faced down the Nazis, hacked their way through the Burmese jungle and fought the Taliban in Afghanistan. Now the Brigade of Gurkhas, the Nepali soldiers who have served in the British forces since 1815, can add another scalp to their collection: that of Phil Woolas, the immigration minister.

Mr Woolas is unlikely to be remembered as the Gurkhas' most fearsome enemy, nor their most cunning. But the metaphorical *khukuri* bludgeoning that he was dealt on April 29th, when MPs of all parties voted for a motion condemning the Home Office's treatment of Gurkha veterans, will go down in the history of the brigade. As the first big parliamentary defeat of Gordon Brown's limping government, it may also one day feature in the history of the Labour Party.

The Gurkha saga has been going on for years, with pay, pensions and immigration rights the main battlefields. The grievance now at stake is that Gurkhas who retired before July 1997 are not granted an automatic right to settle in Britain, on the grounds that they were based in Hong Kong until 1997 and were therefore unlikely to have strong British ties. Newer Gurkha recruits, who are based in Britain, and Commonwealth recruits (who make up more than 6% of all soldiers) may settle after just four years of service. In September Britain's High Court ruled that the discrimination against older Gurkhas was unlawful.

When Mr Woolas eventually came up with new proposals on April 24th, they were widely attacked. Veterans would be allowed to settle only if they met one or more conditions based on length of service, gallantry or related illness. Many of the requirements seemed designed to frustrate: for example, one way to qualify automatically was by soldiering for at least 20 years, though most rank-and-file Gurkhas serve for only 15. Another was to prove that a long-term medical condition was caused or worsened by active service—a tall order for those whose injuries were sustained decades ago.

PA

The actress and the Gurkha

These catch-22s were angrily outlined by Joanna Lumley, a popular actress whose father served with the Gurkhas: she felt, she said, "ashamed of our administration". Members of the all-party parliamentary home-affairs committee described the plan as "unnecessarily restrictive, morally wrong and offensive". The climactic vote against the government, following a debate tabled by the Liberal Democrats, was won by 267 votes to 246. Rebel Labour MPs—27 of them—swung it.

It is a feather in the cap of Nick Clegg, the Lib Dems' leader, who has struggled to define his party against the newly rampant Tories. And it is another self-inflicted wound for Mr Brown's government, which seems increasingly unable to read the public mood. A vote on his panicked proposals to clean up MPs' expenses, scheduled for April 30th, seemed likely, as *The Economist* went to press, to test his authority still more.

Monitoring the internet

Bitwatching

Apr 30th 2009
From The Economist print edition

Plans to store data on internet use are entrusted to the private sector

Illustration by Claudio Munoz

HOME SECRETARIES—who are responsible for law, order and the police, among other things—tend not to have reputations as hand-wringing liberals. So it was odd to hear Jacqui Smith, the incumbent, talk piously of the need to balance security concerns with worries about privacy as she announced, on April 27th, the latest iteration of government plans to monitor people's use of the internet.

On the face of it, Ms Smith was executing a climb-down. Internet and phone companies are already required to store some "traffic data" (that is, details of who was talking to whom and when, but not what was said). But spooks and the police had been lobbying for records to be kept of text messages and postings on social-networking sites too, as well as visits to foreign websites, and for the information to be stored on a government database. Ministers had seemed minded to agree, but in the end the home secretary pronounced the proposal too much. So phone and internet firms will keep storing data themselves, but they will be required to save more information than before.

To critics, there seems little difference between a database run by the government and one run by the private sector to which the state has access. Isabella Sankey of Liberty, a civil-liberties pressure group, points out that the government will have to approve each application to see the privately held data, which might not have been necessary had a government database been built. That should make it harder to conduct the sort of "fishing expeditions"—trawling the data in the hopes of stumbling across wrongdoing—on which the security services were previously keen.

But Ms Sankey worries that access will be granted too readily (last year 520,000 sets of details were handed over, mainly to the police and spooks). Phil Booth of No2ID, which campaigns against surveillance databases, points out that although data on individuals will usually be held by different firms, the new plan requires them to join forces, in some as yet unspecified way, to build a complete picture of every Briton's electronic existence.

Two things may explain Ms Smith's change of direction. One is money. Paying the private sector to run its own databases (at an estimated cost of £2 billion over ten years) will almost certainly cost the government less than building its own. With the public finances in a mess, high-tech security schemes are in the crosshairs. The Tories have reiterated promises to ditch the £5 billion plan for a national identity card. David Blunkett, the former home secretary who launched the identity-card scheme, now thinks it should be scrapped. Several cabinet ministers are rumoured to agree.

The public mood may be shifting too, with growing worries about civil liberties and the misuse of

surveillance powers. The government suffered a humiliating reverse last year over proposals to detain terrorism suspects without charge for up to 42 days. And it has been embarrassed by local authorities using snooping powers intended to curb serious crime to spy on malefactors suspected of gaming the schools-admissions system or leaving their rubbish bins out overnight. Having the private sector, rather than the state, monitor the internet may make little practical difference. But Ms Smith must be glad to have vaguely favourable headlines, for once.

Barclays in the money

High-street high-roller

Apr 30th 2009
From The Economist print edition

The bank has prospered by spurning most state aid but tougher times loom

JOHN VARLEY, the affable chief executive of Barclays, Britain's sole survivor in global investment banking, is likely to announce good quarterly results on May 7th. The boost will have come from trading in bonds and currencies, judging by the results already reported by the bank's chief international rivals, Goldman Sachs, JPMorgan and Deutsche Bank. This is hardly surprising: dealing spreads are wide and many competitors have left the table. Royal Bank of Scotland (RBS), for example, 70% of which is now in government hands, has dropped its global ambitions and is selling off chunks of ABN AMRO, a big Dutch bank that it bought in 2007.

Barclays had the good fortune to lose the bidding war for ABN AMRO, which quickly became a millstone around RBS's neck. It also escaped having to accept a slug of government money to shore up its capital last October, cobbling together a more expensive deal that gives Middle Eastern investors a potential 30% stake. (That upset many existing shareholders in the bank, who were denied an equal opportunity to put in money.) In March the bank resisted joining a government asset-protection scheme which might have capped much of the risk on its dodgy assets, though at a price. "We remain in charge of our own destiny," said Marcus Agius, chairman of Barclays, at the bank's annual general meeting on April 23rd.

The price paid by rescued banks extends beyond the 12% interest on the preference-share capital put in by government. No dividends may be paid to shareholders until the debt is repaid, and bonuses to staff are limited. The second prohibition alone would give pause to Barclays's high-rolling bosses: Bob Diamond, head of investment banking, is one of the best-paid men in British banking. They argue, though, that it is the likely constraints on their foreign business that would be the real straitjacket. Barclays earns more than 50% of its revenues offshore. Its controversial tax-avoidance schemes—some of which were leaked recently to the press—might also attract the attention of a stakeholding government, though "not a single one of the [leaked] documents has not been seen by Her Majesty's Revenue and Customs," according to Mr Varley.

Yet the bank's independence is relative, and there are those who accuse it of having its cake and eating it. Barclays has availed itself of government guarantees to issue at least £15 billion of bonds more cheaply. Until the budget on April 22nd, that guarantee was available without strings. (In order to use it in future, banks will have to give binding commitments to lend to British businesses, so Barclays will probably decide to do without it.) And, like other large banks, Barclays is widely perceived as too big to fail, which is an implicit government guarantee in itself.

Bloomberg

Against this background, Barclays appears to relish pushing the envelope. Last September, as rivals were desperately retrenching, it agreed to buy the American operations of the failed Lehman Brothers. Since then it has battled to convince the market and regulators that it has enough capital to cope. To avoid the government's asset-protection scheme, it underwent a stress test by the Financial Services Authority (FSA). It managed to convince the watchdog that even five more years of awful markets would leave it with core capital equivalent to 4% of its risk-weighted assets, an acceptable, if minimum, ratio in a downturn. Yet credit markets remain sceptical: the insurance premium against default on a five-year Barclays bond with no government guarantee is 2%. Buying cover against default by less racy HSBC, by contrast, costs a little under 1.3%.

The doubt centres mainly on the level of Barclays' toxic assets, which include £8 billion of exposure to American credit insurers and a £10 billion portfolio of leveraged loans: unlike most of its peers, it values these loans on its balance-sheet at 100%. To build its capital reserves

Barclays recently sold iShares, a subsidiary that handles exchange-traded funds, for $4.4 billion. It could probably raise another £8 billion or so by selling Barclays Global Investors, its asset-management business.

But even if Barclays can brush off concerns about whether it has enough capital to mop up losses on toxic assets, its business model could well succumb to the twin assaults of regulators and investors. For Barclays is enthusiastically a universal bank, combining high-street deposit-taking with the roller-coaster of investment banking. The FSA, like regulators in other countries, is thinking of ring-fencing the former—probably by imposing much higher capital charges on trading.

That would make this quarter's extraordinary profits hard to repeat. Barclays can make a decent living from investment-banking fees: government-bond markets will need nifty prime brokers such as Barclays for many years to come. But the returns that have excited investors have mostly come from betting the bank. Under any probable future regime those bets will be rarer and smaller.


Can Varley keep pulling it off?

Equality and the law

A bonanza for box-tickers

Apr 30th 2009
From The Economist print edition

But little to benefit women or the poor

THE environmentally aware will be pleased to hear that the “carbon impact” of the equality bill, published on April 27th, will be “minimal”—although only because the reams of bumf it consigns to history are as colossal as those it will spawn. Connoisseurs of circular bureaucracy will be equally delighted that it comes with an “equality-impact assessment”—upbeat, naturally. All will gain from “clearer and simpler” laws against treating people badly on account of their race, religion, disability, age, sex, sex change (if any) or sexual orientation.

The bad news is the cost of all this. The private sector will have to spend £211m in the first year to comply, and £11m-17m a year thereafter.

This is money that firms can ill afford at present, says Alistair Tebbit of the Institute of Directors, a bosses' lobby group. It is also, he thinks, a gross underestimate. Bureaucrats have totted up the cost of courses for personnel departments and payouts in a few extra employment tribunals—but not of dotting the i's and crossing t's when hiring and firing, or of keeping on substandard workers rather than facing vexatious claims for unfair dismissal. And he rejects the government's claim that employers will gain from having a single equality law instead of nine pieces of legislation and a hundred-odd other bits and pieces. “We're normally in favour of simplification, but pricey entitlements are being added to, and nothing is being dropped to compensate,” he says.

Business groups are particularly cross about plans to make companies employing at least 250 people publish figures comparing the average pay of female workers with that of male ones. They had persuaded the government that its original idea of “equal-pay evaluation audits”, comparing the salaries of men and women doing the same work or work of “equal value”, was too onerous. But they resent being landed with an asinine half-measure in its place. Publishing average figures for men and women, without distinguishing by job, will make engineering firms, for example—all desperate to hire women as engineers rather than secretaries, if more would study the subject—look like sexist pigs.

Also controversial is an ambitious new duty for public bodies such as government departments and local councils: reducing class differences. “Socialism in one clause”, a cabinet minister is said to have called the measure; “class war”, claim the Tories and not a few headline-writers. But the examples in the notes accompanying the bill are pretty mundane: councils ensuring that poor parents know which schools are good; extra money for health care in poor areas.

The disgruntled disadvantaged who miss out on some state-funded good thing such as council housing will not be able to sue. They will, however, be able to seek a judicial review if they think a public body acted without “due regard” for reducing inequality. There may be a recession on, but for equality-impact assessors and the like, the good times just keep rolling.

Bagehot

Charm versus cojones

Apr 30th 2009
From The Economist print edition

Michael Gove, Ed Balls, the politics of education and the perils of preferment

Illustration by Steve O'Brien

PLEDGES are shrinking to aspirations; aspirations are quietly evaporating; no more hoodies are being hugged or huskies stroked (or was it the other way around?). The sunny Californian Conservatism that David Cameron once espoused has been darkened by the crunch. His promise of a happier tomorrow now hangs on a few upbeat policies. Chief among them is education reform—which could make Michael Gove, the shadow schools secretary, among the most privileged and pressured members of a future Tory government.

Ed Balls, his counterpart in the cabinet, is an equally important figure for Labour, before and after the next general election. Ire over public services often focuses on bad hospitals: death is more heart-wrenching than illiteracy. But pound for pound (and there have been a lot of them), Labour's education spending has been less rewarding than its health splurge. It falls to Mr Balls to defend its record on what Tony Blair proclaimed his main priority—and to soften the recession's impact on teenagers and soothe a rumbling moral panic about harm done by and to children.

So Mr Balls's contest with Mr Gove is pivotal. It also offers a compelling contrast of personalities and attitudes to power.

Balls and the vasectomy

Begin with the similarities. Both men have been MPs only since 2005. Both are ex-journalists. Both are tight with their leaders: as Gordon Brown's chief adviser at the Treasury, Mr Balls was known as the "deputy chancellor"; Mr Gove is close to Mr Cameron personally and, as a member of his "Notting Hill" cabal, geographically. Both are very clever. Each is likeable in his fashion. Mr Gove recently told a mostly Muslim audience that their religious liberty was indivisible from that of homosexuals, and that a society's treatment of Jews was a litmus test of its well-being—but too sweetly to raise hackles. Mr Balls learnt his politics on Mr Brown's long, rancorous march to Number 10; in public he is more a basher than a charmer, and his tribal scorn for the Tories can be wearying. But in private he is engagingly rambunctious.

And both profess roughly the same basic motive: to improve the chances of poor children. When Mr Gove addresses Tory audiences, they sometimes seem impatient for him to skip from his odes to social mobility to the bit about improving discipline. But the two disagree about how to realise that goal—a disagreement

more starkly ideological than many front-bench clashes.

Mr Balls is an egalitarian, who believes the benevolent state can compensate for human failings. These views have guided his stewardship of the super-ministry Mr Brown created for him in 2007, the Department for Children, Schools and Families. He has championed a questionable new qualification meant to boost the prestige of vocational training. He has also, say some, undermined the academies programme—a scheme of Mr Blair's that gives selected schools freedom over their curriculum and staffing—through bureaucratic fiddles. At the least, Mr Balls's vision of academies involves more oversight than Mr Blair's.

Or Mr Gove's. He, by contrast, is an old-fashioned liberal. Though the Blair-worship once rife among Tories is now less fashionable, Mr Gove still describes himself as "Blue Blairite". He likes academies and wants to spread the model to primary schools (an extension the government oddly opposes). He also wants to emulate a Swedish initiative and let charities, churches and others set up state-funded independent schools; in theory these would ginger up existing ones. Like most innovations, Mr Gove's would need financial lubrication for capital costs. There is also a risk that rich kids would benefit disproportionately.

Still, his is the Tories' most radical policy. There is only ever a small economy of genuine ideas in British politics, and this is one of them. Yet it isn't really Tory; Mr Blair was groping towards the Swedish model too. Labour has bizarrely surrendered the idea to Mr Gove. Part of the reason, allege Mr Balls's critics, lies in another contrast between them: the scale of their ambition.

As well as a self-confessed Blairite, Mr Gove is a "neocon", a stance potentially at odds with his leader's humbler and fuzzier global outlook. But despite his roving intellect (rare in a shadow cabinet more plodding than pyrotechnic), and although he impersonates Mr Brown, a fellow Scot, in rehearsals for prime minister's questions, Mr Gove avowedly has no wish to extend his remit and take part in the real thing. He would, he says, have a "leadership vasectomy" if the procedure were available. For his part Mr Balls (who is married to Yvette Cooper, the chief secretary to the Treasury) still occasionally opines on economics: he has talked more frankly than his boss about the severity of the slump and the failure of financial regulation. In his case, this public ranging is matched by an aspiration for a bigger role.

Mr Balls would like to lead the Labour Party. Of course, vaulting ambition is neither unusual nor always unhelpful among ministers. But, according to some, Mr Balls's wish to ingratiate himself with Labour members has swayed his stance on academies and other sensitive issues. He vigorously denies having any such long-term plan or ulterior purpose. Yet whatever its motive, his scepticism about school reform could actually undermine him: he risks being remembered more for scandals over chaotic exams and awful social services than for transformative policies.

And he may anyway be nobbled by his closeness to Mr Brown. Mr Balls rose with his mentor, sharing the credit for Mr Brown's apparent economic alchemy (he was the co-architect of Bank of England independence and of the legendary "five tests" that kept Britain out of the euro). Now he is tarnished by the bust. Mr Gove, meanwhile, is rising towards the cabinet on Mr Cameron's frock-coat tails. Both are proof of an old political rule: patronage is a wonderful thing, and a dangerous one.

Economist.com/blogs/bagehot

Islam in Britain and South Asia

A single space

Apr 30th 2009
From The Economist print edition

Theologically as well as socially, Muslims in Britain and their countries of origin form a seamless whole

Corbis

TWO government ministers, both practising Muslims, met in Islamabad, the capital of Pakistan, in April and agreed to co-ordinate their efforts to broaden the curriculum at religious schools. A set of teaching materials would be sent out to madrassas with the aim of enriching the diet. As well as learning the Koran, pupils would be taught how Islam was compatible with citizenship.

This approach, the ministers decided, would work well in their respective countries, Britain and Pakistan. Admittedly, the role played by madrassas in the two places is different. In England's smokestack cities, they are frequented by Muslim children as a supplement to state schooling. In the slums and refugee camps of Pakistan, they offer a meal and an education of sorts to boys who would otherwise be illiterate.

But in both countries, the ministers agreed, madrassas at their most deficient can leave the young open to extremists. That is not just because of what they teach, more because of what they do not, such as how to live peaceably with those who follow a different faith or just another form of Islam. As the Pakistani official told his British counterpart, the cohesion minister, Sadiq Khan, inadequate theology and terrorism can be points on a single spectrum.

Not just for security types and sociologists, but also for theologians, Britain and its ex-dominions in South Asia are virtually a single entity. Schools of Islam that emerged in India as a reaction to the British raj are now vying for influence in the north of England. The passions generated by the Bangladeshi variety of Islamism are as lively in London as they are in Dhaka. Anybody who hopes for stability and social peace in the Muslim parts of South Asia has to keep an eye on the Islamic scene in Britain. The reverse also applies. The flow of South Asian imams to Britain has recently slowed, but in an internet age there are other ways for ideas to travel.

Whenever intra-Muslim tension flares in Pakistan—for example, with the trashing of a Sufi shrine or the takeover of a mosque—Britain's authorities watch for tension in English cities. And the war now raging between the Pakistani government and Taliban rebels is affecting the mood among British Muslims. How

exactly may depend on where they come from, geographically and theologically.

Life would be easier for students of Anglo-Asian Islam if one theological movement always produced moderates and another always led to extremism. But things are never that straightforward. As Philip Lewis, a Bradford-based writer on British Islam, puts it, "In all schools [of Islam], there are some individuals playing a constructive role." And in virtually all schools there are some doing the opposite.

Still, in their Islamic scenes Britain and Pakistan do have one simple thing in common: religious education is dominated by purist teachers, who trace their roots to the Indian town of Deoband where an Islamic place of learning was founded in 1866. Designed to instil and spread a rigorous form of faith (robust enough to survive colonialism and the "corrupting" influences of other cultures), the Deobandi philosophy sets austere rules for personal behaviour. It sees the veneration of saints, and even excessive attention to the Prophet, as a distraction from God.

Among its offshoots are the Tablighi Jama'at, a huge, worldwide missionary movement (strong in Yorkshire and London), in which lay people help to propagate the idea of a pious life. And another offshoot of the Deobandis, as critics always note, is the Taliban, as they emerged in Afghanistan and then in Pakistan.

But that does not mean all Deobandis, either in Britain or South Asia, support violence. Just as well, given that at least 16 of Britain's 22 Muslim "seminaries" (in other words, places that offer intensive, full-time Islamic instruction from the age of 12 upwards) are of the Deobandi persuasion. Their curriculum is modelled on Islamic learning under the Mogul empire.

Tim Winter, an influential British convert to Islam, believes that for all their narrow intensity, the British Deobandi seminaries won't foster violence: their ethos is cautious and traditional. But some alumni of Britain's Deobandi institutions do advocate self-segregation by Muslims, especially where local indigenous culture is dominated by alcohol and drugs.

Anyway, in Britain as in Pakistan, a plurality of ordinary South Asian Muslims follows a different form of the faith: the Barelvi tradition, which celebrates shrines, saints and music. One pioneer of Muslim education in Britain is of the Barelvi school: Musharraf Hussain, an imam who runs a school, mosque, radio station and magazine in Nottingham. He fears that among Britain's Muslim establishment, sectarian splits are becoming "entrenched and fossilised". Some Deobandis retain a deep sense of victimhood and grievance.

Clearly, some young British Muslims ignore the sectarian issues that gripped their parents. Sometimes this reflects secularisation. Sometimes it reflects the opposite: belief in a "global *umma*", or community, that differentiates all Muslims from all non-believers. Still, the Nottingham imam has observed one unexpected side-effect from the turmoil engulfing Pakistan. Many British Muslims, he thinks, will "move on" in a healthy way. They will give up the dream of resettling in South Asia and put down firmer roots in Britain.

A harsher message is emerging from some mosques in the north of England, especially in places like Burnley where many have roots in the war zone on Pakistan's border with Afghanistan. The plight of people fleeing the region is keenly felt. Many blame Pakistan's government, not the rebels. "People think the Pakistani government is fighting not for itself, but for American interests," says Abdul Hamid Qureshi, the chairman of the Lancashire Council of Mosques, which groups Muslims of all shades. People in an angry and defensive mood will hardly welcome Gordon Brown's pledge, on April 29th, to work with the Pakistani army to fight terror. Neither will they take too seriously the prime minister's vow to boost education and ease poverty on Pakistan's border.

British Muslims, who number at least 2m, can amaze their cousins from South Asia with their religious conservatism. One reason is the high incidence of migration from poor, rural parts of South Asia, such as Mirpur in Kashmir and Sylhet in Bangladesh. In Bangladesh the fortunes of the Islamist Jamaat-e-Islami party plummeted in last December's election. But the movement can still attract second- and third-generation youths of Sylheti origin in London, who know little of the group's record at home. Some British-based Bangladeshis are dismayed by the influence the Islamists enjoy in the diaspora.

Worry over radicalism made in Britain extends to Bangladesh, too. In March the Bangladeshi authorities raided a madrassa that was full of guns and ammunition. It emerged that this supposed school had been financed and run by a charity based in Britain. There are some institutions that no teaching material will correct.

Economist.com WORLD INTERNATIONAL

The World Bank and global health

Promising to try harder

Apr 30th 2009
From The Economist print edition

For once, an international institution half-agrees with its critics

YOU are part of a global conglomerate. Your market share has fallen from 18% to 6% in a decade. Well-financed niche-players are moving in, threatening to appropriate the most exciting areas. And now a report by your auditors has said that, even of your remaining business, a third has failed to come up to scratch. If you were a division of General Electric in Jack Welch's day ("Be first or second in a field, or get out of it"), you would probably be facing closure. Who, in these circumstances, would want to be in charge of global health at the World Bank?

World Bank

Yes, some good things happen

The report in question* was prepared by the bank's Independent Evaluation Group, an internal monitoring organisation that reports to the bank's board. It looked at how effective the loans dished out for health purposes by the bank and its private-sector-promoting associate, the International Finance Corporation, have been at doing what they were meant to do.

The sums involved are not trivial. Between 1997 and 2008 the bank provided $17 billion for government-run projects in the fields of health, nutrition and family planning. Over the same period its associate invested $873m in health-related private-sector activity. And although the bank's market share has fallen as new sources of money have emerged, such as the Global Fund (which deals with AIDS, malaria and tuberculosis) and PEPFAR (an anti-AIDS plan started by the Bush administration), the actual amount it lends for health each year has remained fairly constant.

The evaluators' criticism was not just that a third of the 220 projects under scrutiny had failed to achieve their goals, but that those goals were often misconceived. In particular, the bank's remit is to end poverty, but that was the specific objective of only 6% of the projects and a subsidiary objective of only another 7%. Even where poverty reduction was a stated objective, little had been done to find out whether poverty had, in fact, been reduced. If there had been any investigation, it often failed to find any reduction.

There was criticism, too, of the fact that many projects were of a kind more likely to benefit the middle and upper classes which, in poor countries as in rich ones, are often better able to take advantage of infrastructure, such as new hospitals, which the bank helps to create.

Yet another ground for self-reproach was that the failure was concentrated in Africa, the poorest part of the world. Middle-income countries did not do too badly. But in Africa three-quarters of projects were deemed not to be up to snuff.

That is not to say that things were all bad. It is, of course, good that the bank has an independent evaluation mechanism at all. It also remains to be seen whether other global-health bodies are doing better, though that may become evident soon. A report on the Global Fund's impact is to be published in May, and GAVI (the Global Alliance for Vaccines and Immunisation) is also undergoing independent scrutiny. It is also fair to say that the bank's managers have taken most of the criticism on the chin, and promised to do better in future.

What the bank needs, in a crowded market, is a niche of its own, and it is trying to carve one out. Sensibly, it is not competing hard in the fashionable area of infectious disease, which is occupied not only by the Global Fund, PEPFAR and GAVI, but also by the (American) President's Malaria Initiative, the Gates Foundation and numerous bilateral deals between governments. Instead it has, since 2007, been

building up its activities in the less glamorous but equally vital area of “health systems”. This means getting local bureaucracies to recruit the right staff and deliver the right drugs to the right people at the right times, and knocking the heads of aid agencies together to eliminate gaps and overlaps in coverage. That, plus an expansion of its nutritional and reproductive health work, should be enough to protect the agency from a Welch-like fate.

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*“Improving Effectiveness and Outcomes for the Poor in Health, Nutrition and Population. An Evaluation of World Bank Group Support Since 1997”

Company balance-sheets

The sensible giants

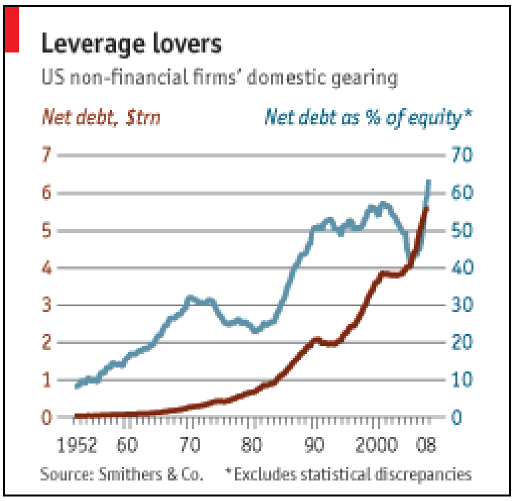
Apr 30th 2009
From The Economist print edition

Big listed firms have surprisingly strong balance-sheets—unlike their private peers

Illustration by David Simonds

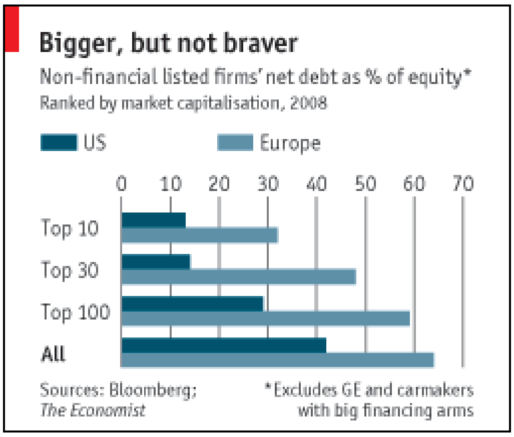
IN RECENT decades running a business or household with a conservative balance-sheet has been a bit like being the only person in an opium den not to inhale. Consumers and financial firms got sky high on cheap debt. Lots of non-financial companies chased the dragon, too. In America corporate gearing is now at its highest level since at least the second world war, says Smithers & Co, a research firm (see top chart). Default rates are near their highest level since the 1930s.

Yet the data reveal a striking oddity: the largest listed firms have disproportionately little debt compared with both smaller listed peers (see bottom chart) and private firms. Of America's ten biggest non-financial firms, no fewer than six, including Microsoft and ExxonMobil, reported net cash positions at the end of 2008. Different accounting conventions make comparisons inexact, but non-financial firms in the S&P 500 index of listed American companies appear to account for only about a third of national corporate net debt, despite contributing a majority of profits. In Europe, with its tradition of bank financing, firms have always been keener on debt, but although overall corporate gearing has risen to "unprecedented" levels, according to the European Central Bank, listed firms have actually steadily cut theirs since 2000.



To grasp why big listed firms are different requires a bit of theory and some history. In theory, chief financial officers spend idle moments admiring charts of the idealised firm's optimal capital structure. From this they are meant to conclude that debt is only

moderately attractive. Since interest payments are tax deductible, but dividends are not, some borrowing makes a balance-sheet more efficient. Too much, though, makes a firm too risky, raising its overall cost of capital. It is a fine trade-off, which at most should add 10-20% to a firm's overall value.



In the real world, however, many managers burnt their textbooks long ago and steadily increased their firms' leverage, taking only the occasional breather in tricky economic patches such as the 1970s and early 1990s. This partly reflects their pay, which is often based on measures (such as earnings per share) that are flattered by higher gearing, giving them an incentive to take on more debt than is justified by mere tax planning. More demanding owners and abnormally low interest rates also led firms to take on more risk.

Financial deregulation, too, has played a big role, notes Jeffrey Palma, a strategist at UBS. A series of new debt products enabled even the leakiest corporate balance-sheet structures to stay afloat—for a while. In the 1980s junk bonds opened up credit markets for lower profile firms. In the most recent boom, companies bought by private-equity outfits, the corporate equivalent of subprime borrowers, packaged their debt into collateralised loan obligations, a form of structured credit that is now as toxic as it is hard to explain. The rash of leveraged buy-outs may account for as much as half of the rise in American corporate net debt since 2002.

How were big listed firms, with fallible boards and demanding shareholders, immune from all this? After all, banks, with identical governance structures, worshipped at the altar of leverage. There are several answers. Some big listed firms have powerful founders who like to keep plenty of cash on hand and who resisted the siren calls of the credit markets. This is the case for three of America's ten biggest firms with net cash positions: Microsoft, Google and Apple.

When institutional investors call the shots, they often like firms to run tight balance-sheets less for tax reasons and more because they fear that managers will blow excess cash on vanity deals and pet projects. But successful firms with highly rated executives are given more latitude. When the fearsome Rex Tillerson of ExxonMobil faced calls to pay a special dividend in 2006, for example, he curtly refused to "scratch the immediate-gratification itch". Likewise, Rick Simonson, chief financial officer of Nokia, says it came under pressure to gear up in 2006-07, but that its bosses had "thick skins" and a good enough record to bat away the criticism.

Size helps, too. Even today nearly half of European and American stockmarket value sits in firms worth over $50 billion. Such firms were too big to be a target of private equity, even at its most hubristic. Without predators breathing down their necks, these firms could play it safe.

Yet not all quoted companies enjoyed the benefits of reputation and size: whisper it quietly, but most were just sensible. The boards of medium-sized firms—such as Motorola or Cadbury—successfully resisted pressure from activist investors to gear up as the economy deteriorated. Having had near-death experiences at the beginning of the decade, big industrial firms in Europe, such as Alstom and ABB, were far more cautious this time round.

Many listed firms saw their profits soar to cyclical highs, but chose to distribute them to shareholders using flexible share-buybacks rather than dividends, which are harder to cut when things go sour. And relatively few quoted firms engaged in the kamikaze debt-funded dealmaking of recent years. Certainly the downturn will claim casualties; some firms are now raising equity to restore their finances, ArcelorMittal being the most recent example. But in general most listed companies remembered that the economic cycle existed—unlike many private peers.

All this is likely to change the debate on corporate leverage in two ways. First, the gung-ho and largely erroneous assumption that higher debt means higher risk-adjusted returns will be replaced with a more measured assessment of the limited boost to tax efficiency that leverage can provide. One banker in London suggests that for the next few years, managers will be prepared to take on more debt only to the

point where they are sure that they can refinance it if another crisis should strike. That suggests that quoted firms could further reduce their net debt from today's level of about 50% of their book equity.

Second, the psychological scars will run deep for the private firms that bear a disproportionate burden of overall corporate debt. Many face bankruptcy, with the destruction of value that entails. Financial regulators, too, are far less likely to tolerate the sort of capital-market fads that allowed private companies to overload on debt at the top of the economic cycle and infect the banking system as they did so. It used to be that equity, as well as lunch, was for wimps. Not any more.

Chrysler and General Motors

End game

Apr 30th 2009
From The Economist print edition

The two carmakers' new, streamlined shapes start to become apparent

AFTER a week of brinkmanship, it seemed that the effort to save Chrysler from bankruptcy had failed. As *The Economist* went to press, Barack Obama was expected to announce that last-ditch negotiations between the Treasury and secured creditors had broken down, leaving the smallest of Detroit's Big Three no other option than to file for Chapter 11 protection. However, Mr Obama was also expected to confirm that a deal had been reached with the Italian carmaker Fiat, offering a reorganised Chrysler a realistic prospect of emerging from bankruptcy quickly and tapping $6 billion in new federal loans.

As the administration's April 30th deadline for achieving an out-of-court restructuring of Chrysler neared, it appeared that the Treasury's twisting of arms and banging of heads was getting results. On April 27th the United Auto Workers (UAW) union agreed to a series of concessions, including the suspension of cost-of-living adjustments, restrictions on overtime pay and, most dramatically, that half of Chrysler's contribution to a union-managed health-care fund for retired workers could be paid in the form of a big equity stake, rather than cash.

The next day a group of four lenders holding 70% of Chrysler's $6.9 billion of secured loans caved in to demands that they swap their debt for $2 billion in cash. As recipients of government bail-out funds, the four banks—JPMorgan Chase, Goldman Sachs, Citigroup and Morgan Stanley—were in a weak position to resist political pressure. But the Treasury had no such leverage with the 40 or so smaller banks and hedge funds that hold the rest of the senior debt. Despite a slightly improved offer from the Treasury, they voted on April 29th to take their chances of getting a better settlement from a bankruptcy court.

Mr Obama and Sergio Marchionne, Fiat's boss, appear confident that enough groundwork has been done to allow a "surgical" Chapter 11 bankruptcy and a speedy sale of non-core assets to pay off debtholders, taking no more than three or four weeks to complete. Bankruptcy should also make it easier for the "new" Chrysler to shed unwanted dealers and other liabilities. But there are uncertainties. Some creditors could insist that the company is worth more to them in liquidation than as a going concern.

The administration dismisses the possibility of Chrysler being broken up. Assuming it is right, on Chrysler's emergence from bankruptcy, Fiat would immediately receive a 20% stake in exchange for running the business and supplying the small-car platforms and fuel-efficient powertrains it urgently needs. Fiat's stake would rise to 35% as long as it meets various targets set by the Treasury. The UAW trust would get 55%, while the government and, potentially, those lenders willing to take equity, would end up with the remaining 10%. Contrary to some reports, the Treasury does not believe that the court will demand that Fiat put up any of its own cash, nor will it consider doing so.

If anything, the structure proposed this week for a reorganised General Motors (GM) by its new boss, Fritz Henderson, is even more extraordinary. On April 27th Mr Henderson put forward a restructuring plan that would result in the government taking a 50% shareholding in the company by way of payment for half the $15.4 billion loan GM has already received, and the additional $11.6 billion it hopes to get at the end of May—its deadline for demonstrating that it has a future. Like Chrysler, GM also proposes giving the UAW health-care trust fund a big chunk of equity—about 39%—instead of $10.2 billion in cash.

But although Mr Henderson can be confident that the government and the union will back his plan, there is rather more doubt whether he will be able to bully investors into exchanging $27 billion of unsecured debt for a 10% equity stake. He has warned that unless the holders of 90% of the debt accept the offer, it will not go through. He also announced a series of measures to cut costs and streamline the business, including the closure of 2,641 GM dealers—42% of the total—and a reduction in the number of workers paid by the hour from 61,000 to 40,000 by the end of 2010.

Mr Henderson wants GM to be capable of breaking even in a domestic car market of 10m sales a year, which is close to today's depressed level. In a slightly more normal market and with a share of 18.5%

compared with the 22.1% it held last year, GM would be decently profitable by 2014. According to one GM insider, it is all a lot more brutal than anything Rick Wagoner, Mr Henderson's predecessor, would ever have had the stomach for.

But the glaring weakness of the proposal is its reliance on debtholders' willingness to accept less than eight cents on the dollar on even the most optimistic equity-valuation assumptions. This looks mean next to the more favourable treatment of the UAW trust, which is owed $20.4 billion by GM and will receive 50% in cash and an equity stake four times larger than that being offered to debtholders. A committee representing some of the bondholders says their legal rights are no different from the union's. In a statement it said: "We believe the offer to be a blatant disregard of fairness for the bondholders who have funded this company and amounts to using taxpayers' money to show political favouritism of one creditor over another."

True, if GM were to enter the bankruptcy courts, as holders of unsecured debt the bondholders could be wiped out entirely. But a sympathetic judge might insist that they be treated on a more equal basis with the union. Unless Mr Henderson finds a way of greatly sweetening the offer before its expiry on May 26th, most bondholders are likely to conclude they have little to lose by trying their luck in court. After the similar display of stubbornness by Chrysler's lenders, that appears overwhelmingly the most likely outcome.

Logistics in China

Return to sender

Apr 30th 2009 | HONG KONG
From The Economist print edition

A new law restores state control to yet another area of China's economy

ONE of the bigger opportunities in China's vibrant, chaotic economy is the lowly task of lugging small objects from one place to another. A relatively mature business in most developed economies, and for decades the sluggish preserve of a poorly run state monopoly in China, it has recently taken off. Part of the dynamism has come from the entry of the big international logistics firms (UPS, DHL, TNT and FedEx) into China; there have also been thousands of private start-ups, their scooters parked in the shadow of every building. A third force has been the rise of several ambitious state-owned companies.

Together, all these firms move a torrent of parcels between China's manufacturers, and a similarly expanding stream of documents, produced by a society that believes even the simplest transaction must be accompanied by receipts with thickets of signatures and "chops" (seals). Overall revenues grew by more than 20% last year, to 40 billion yuan ($6 billion), according to state statistics, but as with many entrepreneurial areas of the Chinese economy, this is probably an underestimate of the true size of the market and its growth.

The good times, however, may be over. On April 24th, after years of tough internal discussions and international negotiations, China enacted a new postal law that seems chiefly intended to prop up the creaking old monopoly, China Post. The new law is troubling in two respects: some parts of it because they are so specific, and others because they are so vague.

Specific new rules will gut many small domestic companies by imposing registration and capitalisation rules, and will severely limit the activities of foreign-owned firms by blocking them from the domestic document-delivery market—a good business in its own right, and an important source of revenue to offset the heavy fixed costs associated with building and operating a national collection and distribution system. Under the new rules the big state-owned companies, notably Sinotrans, China Air Express and China Railway Express, will also have to surrender this market, despite their tremendous success. If that were not disruptive enough, the vague wording of the law means that China Post's monopoly rights are only loosely defined, so competitors will be vulnerable to whimsical expropriation.

Imaginechina

Red letter day

The battle over postal regulation was never going to be easy. It was the last of the large state-owned businesses to undergo post-Mao restructuring, and the regulatory apparatus was separated from the operations only two years ago. The operating entity, China Post, plays an outsized role in China's rural economy. With 70,000 postal branches and 36,000 savings outlets, it is one of the world's largest companies and a vital economic spine for rural Chinese.

Until recently, when enthusiasm for restructuring China's inefficient state-controlled industries began to wane, it still seemed possible that the postal system might be comprehensively overhauled. Postal rates were relatively cheap, but anecdotal accounts of lost letters are legion. Delivery was slow; sending express mail meant waiting in queues. This was precisely the kind of bottleneck that Beijing's bureaucrats were determined to break.

In the late 1990s China Post was technically allowed to maintain its monopoly on letter delivery, but some

Chinese ministries began licensing alternative carriers to transport packages, many of which inevitably contained paper documents. Delivery services were discussed in the negotiations leading up to China's entry into the World Trade Organisation in 2001 and an agreement was reached to open up all areas except those covered by China Post's monopoly. In 2005 and 2006 there were even discussions about splitting off China Post's savings branches and transforming them into rural microfinance operations.

But plans for a big restructuring have now been replaced with greater state involvement, the latest symptom of China's broader retreat on deregulation and trade. The idea of hiving off the banking operations appears to have been dropped. Given the international outcry over the explicit intervention by Chinese censors in the search and e-mail services of foreign internet firms, there is speculation that the government has decided that domestic distribution of information should be kept in Chinese hands. It has also been suggested that the government agreed to expand China Post's monopoly franchise to compensate for a reduction in the subsidies it pays to maintain a national postal network.

The new postal law is due to take effect on October 1st. There will be complaints from firms that are forced to shut down their operations and from customers who rely on them. The biggest loss will be to economic efficiency. Perhaps because China is doing relatively well compared with the rest of the world, its bureaucrats are not concerned—at least not yet. State management did not work in the past; could this time be different?

Two talent agencies merge

Tying the knot

Apr 30th 2009 | LOS ANGELES
From The Economist print edition

A deal signals weakness, not strength

AFTER a long courtship, two Hollywood institutions tied the knot on April 27th. The older, staid partner is the William Morris Agency, which began representing vaudeville performers in 1898 and gradually expanded. The other is Endeavor, a brash 14-year-old agency that has signed up many rising film stars. If the union is approved by Hollywood's guilds and the federal government, the resulting company will rival the mighty Creative Artists Agency.

In principle it is an excellent match. William Morris boasts a thriving literary and music business and has expanded into reality television. Endeavor is strong in film and television drama. The merged outfit should easily be able to cope if one line of work suddenly shrinks, as scripted television did during the 2007-08 writers' strike. Clients of such a broad firm will be able to pursue diverse careers, perhaps branching out from acting to screenwriting, or from music to film—which could be especially useful to them at a time when parts of the media business are struggling.

But talent agents are a gnarly, unmanageable lot. Endeavor is led by Ari Emanuel, who suffers fools no more patiently than his brother Rahm, Barack Obama's chief of staff. The difficulty of accommodating so many large egos helps explain why the merged outfit, which is likely to employ fewer than 1,000 people, will have three chief executives. And disruption is especially dangerous in the talent business. If agents spend too long jockeying for internal power, their clients will be lured away by rival firms.

Hollywood's talent agencies have nothing like the clout that they enjoyed in the 1980s, when Michael Ovitz of Creative Artists Agency bestrode Tinseltown. These days the media conglomerates have the upper hand in most negotiations. Led by Fox, the studios are driving harder bargains, pushing stars to forgo hefty upfront payments in return for a larger cut of the proceeds if a film makes money (many do not). They are making fewer television programmes, which means fewer are ending up in syndication—a crucial source of revenue for the talent agencies. Big music acts are still bringing in good money, but it is an open question whether the iPod generation will support so many of them. In such an uncertain world it is not surprising that two talent agencies should seek the security of a single roof.

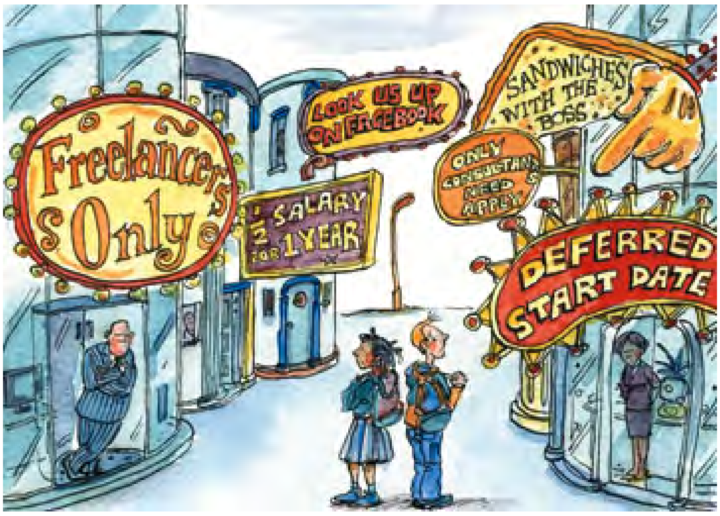
Recruitment

You're hired—next year

Apr 30th 2009 | NEW YORK
From The Economist print edition

The recession is changing the way American firms recruit people

Illustration by David Simonds



IT SOUNDS like something for a racing driver, rather than a company in a recession. But Allan McKisson of Manpower, an employment-services company, insists that companies should be adopting a "ramp-up plan" and hiring new talent now, to ensure that they are firing on all cylinders when the economy rebounds. According to a survey carried out by Watson Wyatt, a consulting firm, three-quarters of American companies have implemented a hiring freeze. But that means around a quarter of companies are still hiring, despite the economic gloom. They are, however, doing so in new ways.

Most obviously, the hiring of freelancers and consultants has become more common, allowing companies to avoid spending on employee benefits and delay hiring decisions until the economy picks up. When they do take on new employees, companies are taking longer to make an offer, knowing that they no longer have to move fast to prevent competitors from stealing their prospective hires. Firms are also marketing themselves differently to job candidates, says Rosemary Haefner of CareerBuilder, a popular job-search website. Lucrative bonuses and international travel were once the main attractions for prospective employees, but companies no longer mention glitz. Their new selling points are sandwiches with the boss, opportunities for advancement, flexible working hours and more holiday time.

Another shift comes from companies' attempts to reconcile their desire to cut costs now with their need for talent later. One solution, popular in many industries, is to offer deferred start dates to new hires, giving them six months or a year to travel or do public service. This approach has been embraced by consulting firms, law firms and banks. Some, like Credit Suisse, offer around six months' salary to new employees who agree to start a year later. Others, including several consulting firms, offer the option without any pay incentive. New hires may be reluctant to accept such an offer, however, in case the economy sinks further and new lay-offs are announced while they are on the beach.

The recession has also changed relations between companies and universities, where recruiting events used to be nearly as prevalent as raucous parties. Not so this year. Because of the slowdown in recruiting, colleges and business schools are going on the offensive. Some have set up networks to help place students with firms run by alumni. Others are organising "job treks", where they send students to network and interview with companies on the university's tab. Some schools have come to terms with the idea that finding full-time work for all graduates might be unrealistic and are creating new schemes to find temporary placements for graduating MBAs. The Johnson School of Business at Cornell, for example, has set up a programme that links MBAs with short-term projects over the summer. This way, students can at least get a foot in the door.

But many doors are slamming in the faces of international students who came to America to study and secure a job. A provision in the Troubled Asset Relief Programme requires companies that receive government funds to hire Americans before foreigners. Bosses such as Lloyd Blankfein of Goldman Sachs have railed against the provision, saying it will harm American firms, but it is likely to stay. Foreign students, it seems, will not.

As companies cut their budgets for hiring, tricks to cut recruitment costs are gaining popularity. Maury Hannigan, who runs a consulting firm called MBA Scouting Report, which identifies promising MBA students for companies but charges less than headhunters, has seen business increase by 40% since the recession began. Sales are also strong at TalentDrive, a firm that makes CV-screening software which helps companies sort through thousands of applications. Some cash-strapped firms are making connections with potential hires in an even cheaper way: through social-networking sites like LinkedIn and Facebook. These are tough times indeed.

Spanish companies in Latin America

A good bet?

Apr 30th 2009 | MADRID
From The Economist print edition

Investments in Latin America offer protection against Spain's slowdown

EUROPE was a grim place during the hard economic and political times of the 17th century. But the mood in Latin America was different, as Ruggiero Romano, a historian, has observed. While Europe's population, consumption and production fell, Spain's colonies thrived.

Spanish companies that have been doing a lot of business in Latin America hope it will buck the trend this time, too. It is so far proving more resilient to the global financial crisis than Spain, where a decade-long boom has come to a halt. Spanish unemployment has just hit 17%, more than twice the European average. The IMF expects Spain's GDP to contract by 3% this year and 0.7% in 2010. Economic output in Latin America, by contrast, is expected to shrink less and recover sooner. The region's institutional strength should shield it from the worst of the crisis, says Alfredo Arahuetes, dean of the Universidad Pontificia Comillas de Madrid.

Telefónica, a Spanish telecoms firm and the biggest investor in the region, says Latin America will be its engine of growth in the next few years. Spanish utilities are also optimistic. "The perception is that Latin American operations are once again becoming a source of strength," says Sergi Aranda, head of Latin American operations at Gas Natural, a Spanish utility.

This is a turn-up for the books. From Mexico's "tequila crisis" in 1994 to Argentina's collapse in 2001, Spanish companies have been on a roller-coaster ride in the region. After nearly two decades of frenzied activity, Spain is now the biggest foreign investor in the region after America. The first wave of serious interest began in 1993, after the establishment of the single European market. Facing increasing competition and the risk of hostile bids from larger rivals in Europe, Spanish firms went to Latin America in search of profits and greater scale.

This coincided with a wave of liberalisation in the region. Spurred on by cultural affinity and a shared language, Spanish firms collectively spent an average of $9.7 billion a year from 1993 to 2000, mostly in Argentina, Brazil and Chile, says Mr Arahuetes. Subsequent crises and some populist policies dampened enthusiasm. Many Spanish companies made big acquisitions in Europe and America to balance their exposure to Latin America. Even so, they continued to invest in Latin America, albeit at a less frenetic pace.

The numbers are eye-popping. Six firms undertook 95% of the investment by Spanish companies in Latin America: Telefónica, Repsol, Santander, BBVA, Endesa and Iberdrola, according to a study by Enrique Alberola, a senior economist at the Bank of Spain. Gas Natural and Union Fenosa also made big investments. The cumulative gross investment by the top five companies was $170 billion. All this generated $28.9 billion of operating profit in 2008. For the six biggest Spanish investors, Latin America accounted for a good chunk (16-51%) of their profits (see chart).

Telefónica has made the biggest bet, spending a total of $100 billion. Analysts believe Latin American assets account for about a third of its $147 billion enterprise value, including debt. Even taking into account the dividends and management fees repatriated over the years, Telefónica's Latin American investments are worth just 60% of their original cost. But telecoms valuations have come down across the board. And Telefónica's performance in Latin America has markedly improved in the past six quarters, notes Jonathan Dann, an analyst at JPMorgan. It has gained or held market share in all big markets except Colombia. Investors appear to back its strategy: its shares have outperformed those of its rivals in the past ten years, and since the credit crunch hit in August 2007.

Not all investments have the same potential. Repsol learnt this the hard way when it bought YPF, formerly Argentina's state-owned oil firm, doubling the size of the company overnight. It paid $15 billion in 1999, only to see the country's economy go into free fall two years later. YPF missed out on the oil-price boom because price controls forced it to sell at below-market rates. Its reserves are dwindling. Repsol sold 15% of YPF last year to a local businessman, with a loan from Repsol itself. Even so, YPF has supplied an average of over $1.3 billion in annual dividends to Repsol since 1999. And Repsol's Latin American fortunes are turning: three of the world's five largest oil-and-gas discoveries last year were by Repsol in Brazil, Peru and Bolivia.

Latin America is also important for Santander and BBVA, Spain's two biggest banks. The region accounted for 43% of Santander's 2008 operating profit and over half of BBVA's. Although both banks were burnt by Argentina's collapse in 2001, BBVA went on to buy out the other shareholders of its Mexican subsidiary in 2004. That bet paid off: the division created $2.8 billion in net income in 2008, against a total investment of $8.35 billion. But the Mexican economy has contracted sharply. A slowdown in Mexican loans in the first three months of the year has hit BBVA's profits in the region. Even so, Mexico and Brazil still offer greater potential than Spain. Santander has strengthened its presence in Brazil, where it bought Banco Real in the carve-up of ABN AMRO in 2007.

Latin America is not a perfect hedge for Spanish companies. Recent devaluations of some Latin American currencies have dented their profits. But if the region manages to recover quickly from recession, it will provide further vindication of their decision to invest so far from home.

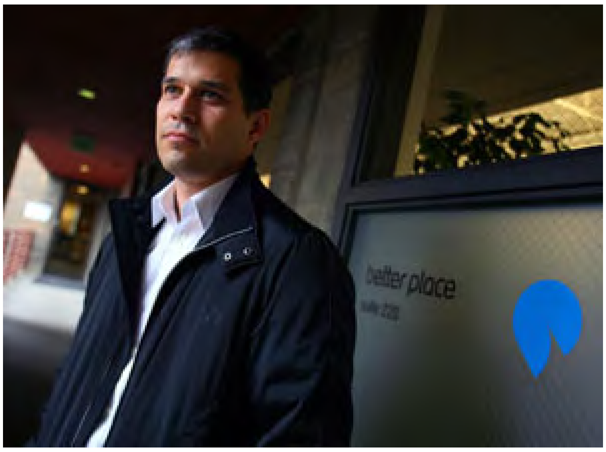
Face value

Electric evangelist

Apr 30th 2009
From The Economist print edition

Can Shai Agassi of Better Place, an electric-car company, honour his grand promises?

eyevine



GERMAN audiences are not always easy to warm up, especially when they are composed of conservative businessmen in dark suits. But the laws of cultural physics were repealed in Berlin last June when Shai Agassi addressed the annual conference of the CDU-Wirtschaftsrat, a business association. By the end of his speech, the mood was that of a religious gathering, with enthusiastic faces, loud cheers and a standing ovation. If Mr Agassi had asked, many would probably have written him a cheque on the spot to finance his start-up, called Better Place. Its goal is to build a global network of charging points and battery-exchange stations to make electric cars a mass-market proposition.

Mr Agassi is the best salesman in the technology industry after Steve Jobs of Apple. Like the charismatic Mr Jobs, he seems to possess a "reality-distortion field" that enables him to convince listeners to believe whatever he says. Yet in contrast to Mr Jobs, who has a string of successful products to his name, Mr Agassi has not yet fully proved that he can deliver the goods. The test will come in the next few months, as Mr Agassi's ambitious scheme begins in earnest. Even as he prepares to unveil his firm's first battery-swapping station in Japan this month, sceptics have started to speak up, casting doubt on Better Place's elaborate business model after months of adulatory media coverage.

Mr Agassi is an unlikely champion for electric cars. Until early 2007 the 41-year-old Israeli was a rising star in the software industry. In the 1990s he founded several software firms, one of which, TopTier, was bought in 2001 for $400m by SAP, a German software giant. Once at SAP Mr Agassi rose quickly, not least because he had the support of Hasso Plattner, one of SAP's founders and its chairman. Within a year he had been appointed to the executive board, and he went on to lead the firm's product development. Widely seen as the heir-apparent at SAP, he started to have second thoughts. Did he really want to spend the next ten years running a lumbering software giant, with its complicated internal politics? His doubts intensified when he took part in a workshop organised by the World Economic Forum. The participants were asked to devise a scheme to make the world a better place, prompting Mr Agassi to cook up his electric-car plan. When Shimon Peres, Israel's president, personally implored him to put it into action, and SAP said he would have to wait two years before taking the helm, Mr Agassi departed and set up Better Place.

Surprisingly, Mr Agassi's firm does not make cars. Instead, his novel approach is to look at electric transport as a system in which cars, batteries, recharging points, electrical utilities and billing systems must all work together. It is, in other words, a systems-integration problem of the kind he used to deal with at SAP.

Better Place's business model involves selling electric cars (provided by its partner, Renault-Nissan) using

a scheme borrowed from the mobile-telecoms industry—charging not by the minute, but by the kilometre. Customers will be able to pay as they go or sign up for a contract that includes a certain number of kilometres. They will even get a subsidised car if they subscribe to big enough packages, just as mobile operators subsidise handsets for their highest-paying customers. Better Place will build networks of recharging points, plus battery-swapping stations along motorways that will, in effect, enable customers to recharge their cars in minutes in order to travel further than the 160km (100-mile) range of their cars' battery packs.

All this will be a highly profitable business, says Mr Agassi: the low cost of electricity compared with fossil fuels will leave Better Place plenty of room for arbitrage, and customers will still end up paying less per kilometre. Clever software will enable utilities to use the batteries in Better Place's fleet of cars to cope with fluctuations in supply and demand, recharging them at night when demand is low and feeding power back into the grid at peak times.

The rubber hits the road

It all sounds excellent on paper, but can Mr Agassi make it work? Even during his time at SAP, critics said his grand visions were not always realised. Some sceptics say consumers will prefer to buy electric cars that plug into ordinary electric sockets than to be "locked in" to an operator of recharging points. Even if Better Place can build its networks, say others, it will not be profitable for years because the infrastructure is so expensive (its battery-swapping stations cost $500,000 each). The latest electric-car designs distribute batteries around the body to improve handling—an approach that is incompatible with Better Place's battery-swapping stations. And won't customers want to own, rather than borrow, the batteries in their cars?

Mr Agassi says such arguments come from those with vested interests in cars powered by fossil fuels—and are "the best proof that we are succeeding". When it comes to his ability to make things happen, he points out that since launching Better Place 18 months ago he has raised more than $300m from investors, despite the financial crisis. He has also signed deals with national and local governments in Israel, Denmark, Canada, Australia, Hawaii and California to build networks of recharging points. The company has developed a robot that can swap a car battery in 40 seconds. It is already installing recharging points in Israel, where it hopes to have 100,000 in place by 2010 and 500,000 by 2011, along with 100 battery-swapping stations.

Electric cars' inherent drawbacks, says Mr Agassi, will not vanish soon: batteries are expensive, and they cannot be charged in the time it takes to fill a tank unless there is a power station next to each charging point. Only when the battery is physically and economically separate from the vehicle, he insists, will electric cars be cheap and convenient enough for the mass market. "Better Place will succeed", says Mr Agassi, "because I have seen no other viable plan for getting the world off its dependency on oil." All he needs to do now is prove he is right.

Global health

Watching nervously

Apr 30th 2009 | LONDON, MEXICO CITY AND NEW YORK
From The Economist print edition

A new influenza virus is spreading across the globe. Our first article asks whether the world is ready for the next pandemic. Our second assesses the economic costs

AFP

THE football stadiums, restaurants and churches of Mexico City are empty, and the latest must-have fashion accessory is the *cubreboca*. Though the army was dispatched to hand out millions of these face masks free, supplies in pharmacies are almost exhausted and people have been outraged as some sellers have raised the price of those that remain to an unheard-of 50 pesos (around $3.50). Whenever someone sneezes or coughs, those nearby try to walk away as fast as they can without being rude. A proffered hand or cheek is treated as though the profferer has plague.

Which, in a sense, he might. As the world now knows, Mexico was the first country affected by a new and deadly strain of influenza that has leapt the species barrier from pigs to people. The first, but not the last. As *The Economist* went to press, 2,500 Mexicans were known to have symptoms that looked like the result of this new virus, and more than 170 had died of them, though only eight of the dead were confirmed carriers of the new virus. That virus has now turned up in 12 other countries on four continents (see map), and the deaths have begun beyond Mexico's borders, starting with a baby in Texas. This could be the beginning of an influenza pandemic—an event long predicted, to the point that many seemed to hear the cry of "Wolf!", especially when money was being spent on precautions.

Those precautions, though, are now looking wise. For on April 29th the World Health Organisation (WHO) promoted the new disease to level five of its six-level pandemic alert. Some countries have built up stocks of antiviral drugs over the past few years. Luckily, they seem to work against the new strain. Vigilance at borders is being redoubled. China and Russia have started quarantining visitors with suspicious symptoms. Asian airports have dusted off heat-sensing equipment they had installed after earlier scares caused by cases of avian flu and severe acute respiratory syndrome (SARS), to detect sick incoming passengers.

Pandemics past and potential

Though the facts are still hazy, the new virus (a strain of the type of flu virus known as H1N1, H1 and N1 being the abbreviations for two of the virus's characteristic proteins) has now captured the world's attention. Three big questions need answering. First, could it turn into a global killer? Second, what lessons arise from previous pandemics? Third, how should governments respond when confronted with an uncertain, but potentially devastating, threat?

Start with the question of whether the new virus is a dangerous pandemic in the making. Seasonal influenza comes and goes (typically, it affects up to 20% of America's population), with the virus evolving slightly from one winter to the next. But every so often a truly new influenza virus emerges, to which few humans have immunity. The resulting global wave of infections is called a pandemic. Humans have lived with such pandemics for centuries and possibly for millennia.

The world is already suffering pandemics of AIDS, tuberculosis and malaria. What makes influenza different is that it is so easy to catch. Seasonal influenza is one of the top ten causes of death in America, and in less developed countries the toll is higher. Influenza viruses are also astonishingly mutable. Their genetic make-up often changes by mistake when the cells they infect churn out new virus particles. On top of that, if an animal or human is infected with more than one strain at the same time, those strains may swap genes. Most such novelties will be evolutionary failures, but occasionally one will prosper and, because it is so new, its hosts' immune systems will be unprepared for it. The result is a potentially pandemic virus. That is what seems to have happened this time.

That deaths from the new virus have mostly been confined to Mexico is probably a consequence of its having appeared there first and spread, under cover of normal seasonal flu, without anyone noticing. The 2,500 suspected Mexican cases would then be the tip of an iceberg, and those who have died were just especially vulnerable, especially unlucky or simply not treated as rapidly and effectively as they might have been in a richer country. It is also possible that there is something unique about Mexico, such as that those who died were infected with another virus which interacts lethally with the new one. If neither of these explanations is true, though, it may mean that a secondary and more lethal mutation has emerged recently, and is now spreading in its turn. And that would be a serious problem for the rest of the world, as well as Mexico.

A perpetual struggle

People worry about a new influenza pandemic for a 90-year-old reason. In 1918 and 1919, in the wake of the first world war, a pandemic known as “Spanish flu” (though it did not start in Spain) killed between 50m and 100m people.

Other influenza pandemics in 1889, 1957 and 1968 were milder. But even the most recent of these is reckoned to have killed at least 1m. A study published in the *Lancet* in 2006 used data from Spanish flu to predict that a modern pandemic of equivalent virulence would kill 62m people, with 96% of those deaths in low- and middle-income countries. Another study, by the World Bank, has estimated that such a pandemic could leave perhaps 70m dead.

Even if the new virus is as virulent as the one that caused Spanish flu, a reason for hoping it will not cause so many deaths is that by good chance it is susceptible to certain antiviral drugs, including Tamiflu, which were not available in 1918. But that is only qualified good news. There is little hope of having enough antiviral treatments for all who would need them if a pandemic struck. What is more, if there were a pandemic it would be only a matter of time before a drug-resistant mutation of the virus emerged.

That points to the third question: how should governments use this time to prepare? This question is made more pointed by the mounting evidence that pandemics can exact a large economic toll on both individual countries and the world as a whole (see article). Thankfully, prodding by the WHO and lessons from SARS and avian flu have caused governments to strengthen their disease-surveillance systems, improve communications channels between their health ministries and co-ordinate their stockpiling of drugs.

All this, however, cannot eliminate the reason why a pandemic happens in the first place—that most people’s immune systems are not armed against the new viruses that can cause one. Time, then, to begin work on a vaccine.

The snag is that the world’s capacity to create a vaccine against pandemic influenza is based on the smaller amounts needed to fight seasonal flu. The capital-intensive approach used to make flu vaccines (an archaic process that employs chicken eggs as incubators) is expensive, slow and not easily expanded to accommodate new variants or altogether new viruses.

Both more, and more effective, vaccines will be needed. Some big vaccine-makers, for example, are bolstering the conventional approach with adjuvants. These are catalysts added to vaccines to improve their efficacy and reduce the amount of active ingredients required. This week, Novartis, a Swiss drugs giant, unveiled the results of its research into an adjuvant-based vaccine against H5N1 bird flu. These suggest its product may offer protection for six years, even against previously unknown strains of the virus.

However, Peter Dunnil, a biochemical engineer at University College, London, says that, even under the most optimistic calculations, and taking adjuvants into account, today’s global vaccine-making capabilities would cover less than 10% of the world’s population. Furthermore, only nine countries—mostly in Europe—have enough indigenous capacity to supply their own people. Even the United States is not self-sufficient. During its last outbreak of swine flu, in 1976, the government forbade the export of vaccine. That might happen again if panic strikes.

It is possible, though, that new technology will come to the rescue. Gregory Poland of the Mayo Clinic, an American hospital chain, argues that thanks to SARS, bird flu and fears about bioterrorism, work has been undertaken on a range of new incubation and manufacturing techniques. One example is DNA-based vaccines, which are made in cell cultures, not incubated slowly in eggs. Vocal, an American biotechnology firm, has shown in early tests that its DNA vaccine for potentially pandemic influenzas, such as strains of H5N1, is safe and effective, and it claims the technology can be scaled up easily. Novavax, another American start-up, has had similarly promising results using “virus-like particles” (made of non-infectious viral proteins purged of genetic material). Rahul Singhvi, Novavax’s chief executive, says that his “portable factories” cost a fifth as much as conventional plants but can still produce millions of doses within 10-12 weeks.

How high a dyke?

If this swine flu is the next deadly pandemic, the world will curse itself for not being fully prepared. But it should not forget how much has been done in the past five years. Besides national and global stockpiles of antiviral drugs, medical equipment and financial resources, many countries and even businesses have developed plans for the outbreak of a pandemic. These plans would be useful in the event of a bioterrorist attack too.

In Mexico, meanwhile, the world’s public-health bodies have generally been supportive, praising the professionalism of the country’s doctors and policymakers and the swift measures implemented once the virus was identified. And according to Roy Campos, a pollster, public opinion has by and large been favourable to the government so far. Mexicans think officials have acted appropriately and believe the information they are receiving, though rumblings of criticism are starting to be heard about how long it took to identify the virus in the first place, and of failings in the health services’ response.

Julio Frenk, a former Mexican minister of health who now runs Harvard’s School of Public Health, insists that the world today is “much better prepared…everyone has been waiting for such an event.” He is right. It remains to be seen, though, whether the fortifications are strong enough to withstand the assault.

Flu and the global economy

The butcher's bill

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Recession may dampen the economic cost of a swine-flu epidemic

THE scares over bird flu since 1997 and severe acute respiratory syndrome (SARS) in 2003 have spurred research into the economic costs of pandemics. Studies paint a grim picture of what swine flu could mean for the world economy. For example, World Bank economists estimated last year that a pandemic with death rates similar to those in the Spanish flu that swept the world in 1918-19 could shrink global GDP by 4.8%.

Although such research can help to identify the economic effects of swine flu, global recession means that some of the mechanisms it describes are already at work. The recession means, perhaps counterintuitively, that the incremental economic effect of a pandemic may be less dramatic than it would be in normal times.

Economists argue that a pandemic would affect both global demand and global supply, but that the first of these is particularly vulnerable to the uncertainty and fear surrounding even the possibility of widespread disease. That would cause consumer spending to fall and businesses to put investment plans on hold.

Asia's experience with SARS is a guide. The outbreak caused a sharp drop in private consumption in the economies it affected. People avoided going out—as they are doing in Mexico. On April 29th the country's president, Felipe Calderón, announced a national suspension of non-essential activities from May 1st to May 5th. The cancelling of sporting events and concerts, the closing of bars and nightclubs, and people's propensity to stay inside had already cost Mexico City's service and retail industries $55m a day from April 24th, when authorities first closed schools. That sum was expected to double after a ban on restaurants seating customers.

Financial markets have reacted sharply: the peso has fallen by 5.5% against the dollar since the emergency began. Mexico's finance minister, Agustín Carstens, has said that he expects the economic cost to be 0.3-0.5% of GDP, based on Asian precedents. Luis Flores, an economist at IXE, a bank, reckons that the government's budget deficit could increase by 0.7% of GDP.

This outbreak has happened when, worldwide, consumer confidence is low. So any further drops in demand because of a swine-flu pandemic may be smaller than those caused by SARS, when airline-passenger arrivals in Hong Kong fell by nearly two-thirds in a month. But a pandemic would dent hopes of a rapid recovery from recession, by providing yet another reason for gloom to continue.

The uncertainty caused by a pandemic could hit investment too. Risk premiums for countries affected by the pandemic might rise. And worries about safety, justified or not, pose risks to trade. Already, China has banned Mexican pork, though there is no evidence to suggest that meat spreads flu viruses. World trade is already plummeting. Widespread reactions of this sort could steepen its dive.

More than fear itself

The potential supply-side effects of a pandemic come mainly because people fall ill or die. Infected people cannot work, and others must take time off to care for them. This has an immediate effect on the size of the labour force, but with consequences that last many years. The future output of those who die is lost. That is especially important when people of working age are taken. The worst economic consequences of AIDS have come from death and sickness among young adults.

Getty Images

As busy as it gets

The worldwide costs from deaths and hospitalisation are hard to calculate in the absence of information about medical costs in each country. However, Martin Meltzer, Nancy Cox and Keiji Fukuda, now deputy director-general of the World Health Organisation, did the sums for America in a paper in 1999. They found that a pandemic affecting 15-35% of the population would have cost between $71.3 billion and $166.5 billion (in 1999 dollars).

The bulk of this would come from forgoing all that the sick and the dead would have produced. In other words, it is an estimate of the effect on the potential output of the American economy. Because of the global slump, many more people are already out of work than in normal times. This probably means that the immediate cost of additional losses in output would be smaller than in the estimates made by Mr Meltzer, Ms Cox and Mr Fukuda.

Several studies have put all this together to estimate the overall impact of a pandemic on economic growth. In 2006 Warwick McKibbin and Alexandra Sidorenko found in a study for the Lowy Institute for International Policy in Sydney that even a mild pandemic could shave 0.8% off world GDP. For the worst possibility they considered, the drop would be a staggering 12.6%. They reckon a pandemic similar to the one that began in 1918 would reduce growth in the American economy by 3 percentage points and in Japan by 8.3 points. Roughly comparable numbers emerge from a study by economists at America's Congressional Budget Office (CBO), which found that a Spanish-flu-like pandemic would lower real GDP growth in America by about 5 points. Even a milder episode would lead to a 1.5-point drop.

These are large declines. The CBO notes that a severe pandemic would be like a typical post-war recession. As it happens, the worries about swine flu come when the world is already in its worst slump since the war. That would dampen the economic effects of a pandemic. But if a pandemic does occur, this would be small comfort indeed.

Bank shareholders

Changing course

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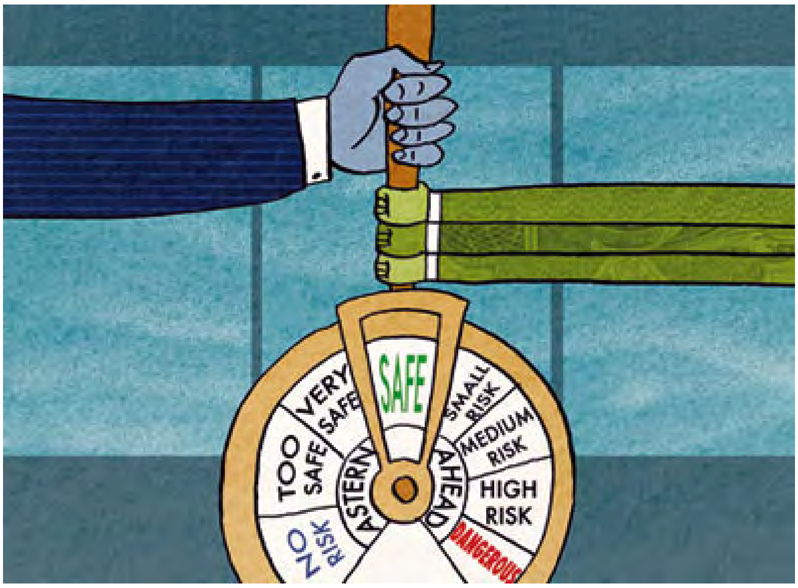
From The Economist print edition

Bank of America's shareholders get tough—sort of

Illustration by S. Kambayashi



KEN LEWIS, the boss of Bank of America (BofA), famously said he had had as much fun as he could stand in investment banking in the autumn of 2007. How on earth must he feel now? Mr Lewis's decision to buy Merrill Lynch in September has cost him his reputation, his independence and, on April 29th, one of his many titles. At the bank's annual general meeting shareholders re-elected Mr Lewis to the board, but voted to split the role of chairman and chief executive. Walter Massey, a board veteran, replaced him as chairman. Mr Lewis can count himself lucky. True, there was strong logic in buying Merrill Lynch, with its coveted retail brokerage, and Countrywide, a sickly mortgage lender, before that. True too, that the government resisted his belated attempts to get out of the Merrill deal in December, as losses at the bank rapidly worsened.

But these are figleaves. The Merrill deal was stitched together too quickly. Mr Lewis agreed on a price (in shares, to give him some credit) that looked inflated even before Merrill posted losses of more than $15 billion in the fourth quarter. "As a group, they are not disciplined buyers," says Jonathan Finger, a disgruntled shareholder. Claims that Merrill paid out lavish bonuses to employees without BofA's say-so, and that Mr Lewis was forbidden by officials to disclose details of Merrill's losses to shareholders (both disputed), make BofA's managers look impotent at best and contemptuous of shareholders at worst. Hostile investors argue that Merrill was already burning money when they voted on the deal on December 5th, before Mr Lewis crossed swords with the government.

The bank's share price has lost more than three-quarters of its value since September. Things could yet get worse. Leaks about the results of the stress tests that have been conducted on America's largest banks suggest that BofA, which has already received $45 billion from the government, needs yet more capital (it would probably not be the only supplicant). This could well mean that the government's preferred shares are converted into common equity. If other investors do not want to get rid of Mr Lewis, the government may do it for them.

For bank shareholders in America, the ground is slowly shifting. Managers and boards will find it much harder in future to argue that they know best after the pasting they have given investors. Chuck Schumer, a Democratic senator, is reportedly planning a bill requiring non-binding "say on pay" votes, independent chairmen and annual elections for boards of directors. The Securities and Exchange Commission is also expected to enact two reforms. One would make it easier for shareholders to nominate their own

candidates to the board. The other would stop retail brokers from casting votes, almost always in favour of management, on behalf of investors who have not given instructions on how to vote. These broker votes accounted for roughly a quarter of the BofA ballots.

Working out what effect enhanced shareholder rights would have on banks is harder. Governance activists in America typically laud the shareholder regime in Britain, yet the British banks fouled up just as badly as everyone else. Take RBS, where the shareholders merrily voted to buy ABN AMRO—the deal that sank the bank—after the credit crunch had struck.

The sympathetic explanation is that shareholders face a difficult job of holding banks to account. Banks are opaque and complex firms. Working out the risks they were taking on was apparently beyond most managers, let alone shareholders. Banks are heavily regulated, which created an unhealthy reliance on supervisors, who were also incapable of understanding the risks. And banks are fragile, which makes shareholders think twice about flexing their muscles when confidence is shaky. “There isn’t a halfway house to register effective dissent without risk of nuclear war,” says Peter Montagnon of the Association of British Insurers.

That worry still preoccupies some BofA shareholders. The bank argues that Mr Lewis and his team are skilled at integrating acquisitions; now that Merrill and Countrywide have been bought, in other words, shareholders would cut off their own noses by getting rid of them. That is a bit like saying BofA managers are experts in getting out of holes they have dug for themselves. But the judgments are finer for other banks. Take Barclays, which riled shareholders with a dilative capital-raising in October but has avoided taking government cash. On April 23rd an unusual number of shareholders opposed the re-election of Marcus Agius, Barclays’ chairman, but nowhere near enough to threaten his appointment. That seems supine to some, pragmatic to others.

Even when shareholders raise objections, it is apparently too easy for executives to ignore them. The boss of Legal & General, a large institutional shareholder, has described the way British banks ignored its advice during the crisis as “sobering”. Some think the role of lead independent directors needs to be beefed up. Another idea is for a committee of the most powerful shareholders to dig deeper into the composition of the board. Increased public scrutiny will also make it harder for executives to brush off criticism. Daniel Bouton announced his intention to resign as chairman of Société Générale on April 29th, citing personal attacks since a rogue-trading scandal forced him out of the chief executive’s job a year ago.

There is another, more sinister explanation for the failure of shareholders to discipline their managers—they do not want to. Shareholders accrue all the gains from risk-taking, but their losses are capped by the amount of equity they hold. Once capital is wiped out, any further losses are borne by creditors. A forthcoming paper by Shams Pathan of Australia’s Bond University finds that bank boards that are more aligned with shareholders’ interests are more likely to take risk than those that are under the thumb of the chief executive.

When banks have only thin slices of equity, or when share prices have dropped precipitously, shareholders’ propensity to gamble goes up even more. A new paper from Lucian Bebchuk and Holger Spamann of Harvard Law School suggests that bankers’ pay be tied not just to equity but to other bits of the bank’s capital structure, such as preferred shares and bonds. Giving shareholders more control makes sense, but like every other solution to this wretched crisis, it creates problems of its own.

Wall Street's chief executives

Second life

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From The Economist print edition

They used to walk on water. Now they are back from the dead

GOLFERS sometimes play a “mulligan”, a second attempt at a bad shot. The same is true in finance. Wall Street prides itself on being a meritocracy, but those who fail spectacularly often get a second chance: think of John Meriwether of Long-Term Capital Management.

As with former hedge-fund stars, so with the fallen titans of the credit crunch. Alan Schwartz, who steered a clapped-out Bear Stearns into JPMorgan Chase’s arms for a mere $10 per share, is said to be close to joining Goldman Sachs as a partner, though several other firms are wooing him. And this week John Thain, Merrill Lynch’s former top dog, took a first stab at rehabilitation by accusing Bank of America of underplaying its role, and exaggerating his, in concealing Merrill’s big losses and bonuses after agreeing to buy the firm last September.

Mr Thain hopes to run another public company—oddly, he still wears a suit most days despite having no job, according to the *Wall Street Journal*. His reputation seems salvageable. When he took over at Merrill, most of the damage was already done. Though his lavish office redecoration hardly endeared him to the public, he is still well-regarded on Wall Street. And the more credibility Bank of America’s Ken Lewis loses, the better it should be for the man he fired. Mr Schwartz, too, can claim mitigating circumstances. He was handed the reins at Bear only two months before its implosion (though he was one of Jimmy Cayne’s top lieutenants before that). He is, by common consent, a top-class dealmaker (the sale of his own firm aside).

Even the most tarnished former bosses are getting offers. Dick Fuld, though apparently haunted nightly by Lehman’s slide into bankruptcy, is getting enough sleep to have landed a job at Matrix Advisors, a hedge fund. Stan O’Neal, who oversaw Merrill’s disastrous foray into toxic mortgage assets, then left with a $161m pay-off, has just joined the board of American Beacon Advisors, an investment firm. He already sits on Alcoa’s. Chuck Prince, Citigroup’s former bumbler-in-chief, is a vice-chairman and “global business ambassador” at Stonebridge, a consulting firm (and on the boards of Xerox and Johnson & Johnson).

AP

We won’t get Fuld again, will we?

Such fallen stars have plenty of useful experience, to be sure. “Someone who fumbled in the last play is likely to hold the ball tighter,” says Dennis Carey of Korn/Ferry, an executive-recruitment firm. A competitor puts it less delicately: “If you want good security, hire a thief.”

There are risks, too. Mr Fuld still faces a wave of lawsuits, which may turn some investors off Matrix. Still, if Eliot Spitzer can bounce back from a sex scandal, why shouldn’t his erstwhile quarry on Wall Street, whose sins were merely pecuniary, also get another chance?

Corporate bonds

Empty coffers

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From The Economist print edition

Bondholders of bankrupt companies are being left with a pittance

INVESTORS buy bonds for security as well as income. When a company goes bust, the bondholders have an early claim on the business's remaining assets—a much better claim than shareholders do.

In this recession, however, defaults are clobbering everyone. In many recent bankruptcies, prices on unsecured bonds suggest holders will be left with less than ten cents on the dollar (see table). Even secured bondholders, whose claims are backed by specific assets, would get back just over 15 cents. In the pre-crisis world, bondholders tended to get a recovery rate of more than 40 cents, analysts say.

Slim pickings
Recovery rates for unsecured senior bonds issued by bankrupt companies, Q1 2009
By filing date

Company	Recovery rate*
Millennium America	6.00
Merisant Co.	10.0
Merisant Worldwide	0.10
Tronox Worldwide	11.5
Nortel Networks	12.2
Smurfit-Stone Container	9.50
Spectrum Brands†	21.5
Aleris International	0.03
Young Broadcasting	0.01
Great Lakes Chemical Corp.	18.3
Chemtura Corp.	45.0
Charter Communications Holdings†	0.60
Idearc Inc.	2.00

*Average value-weighted bond price (cents on the dollar), 30 days after default
†Pre-packaged Chapter 11
Source: Goldman Sachs

Why the shortfall? One reason, as Jim Reid of Deutsche Bank points out, is the link between recovery rates and default. Recovery rates tend to be low when default rates are high, as they now are. That is because high default rates occur when economies are in trouble and business assets have to be offloaded at fire-sale prices.

But this alone cannot explain the collapse. Goldman Sachs says recovery rates during recessions have historically averaged 20%. A second explanation concerns the type of companies that borrowed during the boom. Steve Dulake, head of credit strategy at JPMorgan, says yield-hungry investors were prepared to back riskier companies in 2005 and 2006 and that businesses with highly cyclical records were the targets of leveraged buy-outs. As economies have slumped, such companies have seen their revenues drop and they have a slimmer hope of being refinanced.

The use of "covenant-lite" bonds and loans issued with devil-may-care zeal during the boom are also coming back to haunt lenders. Covenants protect investors by requiring companies to take action when their finances start to deteriorate. In their absence, bond investors have been able to intervene only at a later stage, when firms have fewer assets left.

Given that defaults have been high and recovery rates low, it is surprising that high-yield bonds have earned positive returns so far this year. But that may reflect the terrible beating such bonds took in the late stages of last year. By January bonds were pricing in a catastrophe; instead, the fundamentals have just been very, very bad.

With short-term rates near zero, investors have been lured into bonds in search of income. According to Goldman, retail investors have put $8 billion into high-yield mutual funds since December 1st. But will such flows survive a high-profile default such as General Motors?

Securitisation

The torpor of the TALF

Apr 30th 2009 | NEW YORK
From The Economist print edition

A much-trumpeted facility falls victim to politics

BANKS get most of the blame for the credit crunch, but the fall-off in lending has been steepest among non-banks, particularly buyers of securitised products, loans that are packaged into (supposedly) tradable securities. This is especially true in America, where securitisation comfortably eclipsed old-fashioned lending in the go-go years. A crucial weapon in the battle to reverse this contraction is the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF). Announced last November and officially launched in March, it looks more like a damp squib so far—not because its economics are unappealing, but because the politics are so toxic.

The concept behind the TALF is sound. The Fed will lend up to $1 trillion to buyers of top-rated securities collateralised by credit-card, car, student and small-business loans. Though the Fed gets a bit of extra security from investors in the form of a "haircut", the loans are "non-recourse", meaning it has no right to the borrower's other assets if they are not repaid. That limits the borrower's downside and all but ensures juicy returns. In the first round, however, a mere $4.7 billion of loans were requested. That fell to $1.7 billion in the second round in April.

There are several reasons for the lack of demand. The industry disliked the voluminous documentation and some of the financing terms—so the Fed streamlined the paperwork and revised some details. A bigger problem lies with the primary dealers, the big Wall Street firms tasked with running the facility. They forged a standard "customer agreement" that most investors find unpalatable because its terms favour the arrangers. A few of the dealers have now broken away from the group and softened their terms, opening the way for more hedge funds to participate.

But the most important problem is that potential buyers, particularly hedge funds, fret that executive-pay curbs on those receiving money from the Troubled Asset Relief Programme (TARP) could extend to TALF participants. Their loans, they note, are ultimately secured by TARP funds since the Treasury has pledged $100 billion to cushion the Fed from losses. They also worry that Congress will claw back profits it perceives to be excessive. Some constraints already affect them: all participants in government programmes, including the TALF, face restrictions on hiring foreigners. "For an industry like ours that has not needed any aid, it is very scary," says Brad Schwartz of BlueMountain Capital, an asset manager.

The Fed argues that the TALF's mere existence has helped bolster general confidence. Risk premiums on asset-backed securities have tightened. New issuance, though still at one-twentieth of pre-crisis levels, according to Thomson Reuters, is up dramatically from last autumn's virtual freeze—though how much of this is down to the TALF is debatable.

Interest is growing, to be sure. One bank claims to have 30 clients preparing to invest. Ford Credit, which sold $3 billion of eligible securities in March, is planning to issue more. Ajay Rajadhyaksha, of Barclays Capital, thinks the TALF may turn out to be like America's guarantee scheme for bank debt, which began unpromisingly but took off once it reached critical mass. Dealers say demand will increase in May's third round, perhaps topping $10 billion.

Still, there are reasons to doubt the success of the "bold expansion" of the TALF promised by the Treasury. The idea is that this would finance not only new asset-backed debt, but also part of the public-private programme to remove toxic assets from banks' balance-sheets. This plan is beset with teething troubles. The Fed is also working to extend the TALF to commercial mortgages (and, possibly, residential mortgages too). But this market is deteriorating so fast that some officials worry about the Fed becoming saddled with hard-to-value securities if it has to take on the collateral. And, at three years, the maturity of TALF loans is too short for most commercial-mortgage investors. There is talk of expanding it to five years.

Much rides on making the TALF work, if only in its original form. If the economy is to recover,

securitisation must be revitalised; banks cannot come close to plugging the gap. If the programme is to fulfil its promise, however, investors may need more reassurance that they will not become the next target of the anti-bail-out backlash.

Online marketplaces

New bids on the block

Apr 30th 2009
From The Economist print edition

Frozen credit markets present an opportunity for some

INNOVATION is a dirty word in finance these days but, with securitisation markets gummed up, fresh thinking may be just what credit markets need. Prosper and DebtX, two online marketplaces with very different customers, are among those who think they stand to gain.

Prosper's principal business is as an online peer-to-peer lender, matching up individual borrowers and lenders. Since October, Prosper has been dormant as it goes through registration with America's Securities and Exchange Commission. But on April 28th, thanks to special dispensation from the Californian authorities, the website started up again.

With credit scarce and savers battered by low interest rates, the ground is already fertile for standard peer-to-peer lending. But Prosper has now started to let institutional lenders use its platform to auction off consumer, car and small-business loans to Californian residents. Before they can sell them, lenders must have held the loans for at least three months, in order to establish a payment history. Prosper members can see the borrower's credit history and view any collateral. They can then bid to buy a slice of the loan based on the yield they are willing to accept.

DebtX, which has been around for longer, operates very differently. Whereas Prosper aggregates lots of small bids from ordinary investors, DebtX sells larger loans in asset classes such as commercial property in their entirety to institutions and sophisticated investors. Many of those loans are distressed. DebtX has attracted plenty of business in recent months from the Federal Deposit Insurance Corporation, as the regulator tries to sell off the assets of banks that it has taken into receivership. But Kingsley Greenland, DebtX's boss, says that pricing, not liquidity, is the main problem in selling these loans. DebtX has a team of advisers to help sellers price loans before they ever come to auction.

Despite these differences, both Prosper and DebtX put the onus on investors to conduct their own due diligence and to diversify their portfolios, rather than to rely on rating agencies and pooled loans to do it for them. Prosper and DebtX look promising, but it is too soon to say they are better than all those other financial innovations.

Buttonwood

Bucking the trend

Apr 30th 2009
From The Economist print edition

The end of the carry trade brings a new era of complexity to currency markets

Illustration by S. Kambayashi

FROM 2002 to 2007, foreign-exchange trading was pretty simple. Buy the currencies with the highest yields and sell those with the lowest. This "carry trade" created high returns with low volatility.

In theory the trade made little sense. High-yielding currencies should be compensating investors for the risk of depreciation, and low yields have been a characteristic of strong currencies like the Swiss franc. But who cared about the theory when, for a long time, the carry trade produced bumper returns?

Then came the credit crunch and some carry trades broke down spectacularly. The high yields on offer from Iceland did not compensate investors for the collapse of the krona. East European debtors are still coming to terms with the downside of one carry trade, borrowing in low-yielding currencies like the euro or Swiss franc. It saved them interest costs in the short term but it also created a nasty mismatch: their wages and revenues were in one currency and their liabilities were in another.

Now markets have reached a stage, in the biggest economies at least, where the carry trade looks hard to pull off. Thanks to the desperate efforts of central banks to revive their economies, most currencies yield virtually nothing. There is not enough of a spread between the dollar, euro and yen to reward speculators.

Although that is true in nominal terms, David Woo of Barclays Capital argues that there is still a difference in real yields. America is now officially in deflation so real yields on Treasury bonds are around 3%. That compares well with real yields in Japan, Canada and Britain and it may be attracting capital flows into the dollar.

But another possibility is that the focus has moved away from yields to other factors. This would not be the first time. In the late 1990s America's superior growth prospects were perceived to be good for the dollar, as the country attracted portfolio flows into technology stocks. At other times, trade patterns have dominated, with deficit countries perceived to be vulnerable to currency declines.

What could be the basis for the new regime? Adam Cole of the Royal Bank of Canada reckons the answer is the credibility of economic policy. In America the authorities have shown themselves willing to try everything to boost the economy, including lower interest rates, bank rescues, fiscal stimulus and quantitative easing (expanding the money supply). In contrast, the European authorities have been more cautious. That is why the dollar has been strong against the euro recently.

This is odd. Running budget deficits and printing money tend to weaken a currency. David Bloom of HSBC argues that the currencies of those countries that have adopted quantitative easing will underperform those that have not.

But it may be a sign of the severity of the crisis that currency traders are willing to ignore their misgivings about such unorthodox tactics. As Ajay Kapur of Mirae Asset Management puts it: "In a debt deflation, the currency of the least responsible country benefits."

Another possibility is that currencies are being driven by risk appetite. That seems to be true in developing countries: emerging-market currencies have rallied alongside equity markets in recent weeks. And it makes a certain amount of sense. If rising stockmarkets are a sign that the world economy is stabilising, then export-driven emerging markets should be the first to benefit.

When investors turn risk-averse, they seem to favour the dollar, as was illustrated yet again on April 27th when the outbreak of swine flu caused the greenback to gain ground. A further reason why the dollar may be benefiting during stockmarket sell-offs is because American investors, who piled money into foreign shares in recent years, are bringing their money back home.

And the dollar may also be gaining a following from those who focus on trade deficits as an important agent in foreign-exchange markets. For years, the size of the American current-account deficit was seen as bearish for the buck. But the global slowdown, and in particular the falling oil price, have caused the deficit to shrink dramatically.

The new world of foreign exchange may thus be much more complicated than the old. But for the moment most factors seem to be favouring the dollar. Ironically, the greatest danger for the greenback might result from the success of the efforts of the Treasury and the Federal Reserve to revive the global economy. Not only might investors start to chase high yields again, but they might also start to worry about how the bill for all those unorthodox policies is going to be paid.

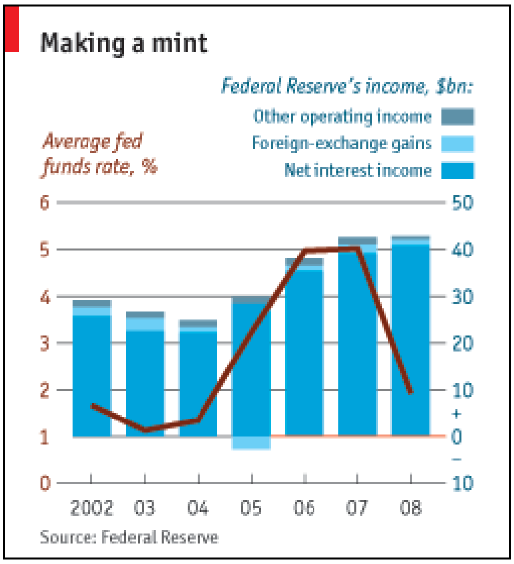
Economist.com FINANCE & ECONOMICS

The Federal Reserve

The hedge fund of Foggy Bottom

Apr 30th 2009 | WASHINGTON, DC
From The Economist print edition

If you do not adjust for risk, the Fed is making good money for Uncle Sam



THE Federal Reserve does not set out to make bumper profits. But its 2008 annual accounts, released on April 23rd, would turn many a hedge-fund manager green with envy.

Like Wall Street's finest, the Fed makes money on a spread. Its main source of funds comes from issuing cash, since currency in circulation is, in effect, an interest-free loan by the public to the central bank. The interest it earns on its loans and securities is almost pure profit, or "seigniorage," most of which it remits to the Treasury.

Last year the central bank reported a whopping $43 billion in operating income. That was more or less the same level as in 2007, but meanwhile short-term interest rates had plummeted, ending the year near zero. That should have clobbered Fed income, as rate cuts did in the early days of the last recovery in 2002-04 (see chart).

But it did not, for two reasons. First, to shore up financial markets the Fed has pumped up its balance-sheet—its total assets were $2.2 trillion on December 31st, more than double their level of a year earlier. Second, it has been trading in low-risk, low-return Treasury debt and buying higher-yielding private debt—discount loans to banks, commercial paper, and mortgage-backed securities, for example.

The Fed has, in effect, been adding both risk and return to its portfolio. So far so good, despite mark-to-market losses on the securities it acquired bailing out Bear Stearns and American International Group. But as hedge-fund managers have learnt of late, you "reach for yield" at your peril. The risk is an occasional hit big enough to wipe out years of profits.

Derivatives

Fashion victim

Apr 30th 2009 | BERLIN AND ROME
From The Economist print edition

A derivatives scandal in Milan may be the tip of an iceberg

AFP

YOU might have expected more from people whose forebears invented the phrase *caveat emptor.* On April 28th it emerged just how unwary city elders of Milan had been when details emerged of staggering sums they have allegedly lost on a derivatives bet.

The disclosures came amid a swoop by the country's financial police on some of the world's biggest banks, seizing €476m ($634m) of their assets. The four banks, UBS, JPMorgan Chase, Deutsche Bank and Hypo Real Estate's DEPFA unit, helped the city take a huge bet on interest rates in 2005 that had lost Milan, by its own estimate, €298m last June.

The banks are declining to comment on the case. In it, Italian prosecutors say they are investigating whether the banks fraudulently made more than €100m in "illicit profits" from the Milan deal and took advantage of naive buyers.

Yet the case has ramifications around the world as other big banks face accusations of mis-selling complex products before the credit crunch. Should there be restrictions on whom they sell such financial dynamite to? And should some institutions, such as local governments, be protected from themselves?

When Milan signed the deal in 2005, it thought (and, investigators suspect, it was assured) that it could barely lose from the deal. In an effort to cut its borrowing costs, it swapped the fixed interest rate it was paying on about €1.6 billion in borrowings for a floating rate. Prosecutors claim that the bankers promised Milan savings of almost €60m. Although the details of the transaction are vague, it seems that the city council agreed on an "interest-rate collar" that meant it would have been paid if rates increased but would have had to pay out if rates fell.

That such big potential penalties were missed by (or, as investigators suspect, concealed from) the council is staggering. A clue as to how this may have happened is found in a revealing deposition by an official involved in the negotiations who, according to *Il Sole 24 Ore*, a newspaper, swore that: "The banks' representatives always presented every operation to me as being in the council's best interests, always underlining—now I realise—only the profitable short-term aspects." This positive spin, investigators suspect, was central to the deal. Under Italian law, councils can restructure their debts only if it leaves them in a better position than before.

Whether Milan was fooled or just plain foolish (people involved in the deals claim it has benefited from offsetting gains), it is not the only public body to have played dangerously with derivatives. Achim Duebel, a consultant in Berlin, reckons that as many as 700 German local authorities could lose money on such instruments as a result of a combination of mis-selling and insufficient financial regulation of local authorities. Such bets could have gone either way for the councils. But they were usually in the interests of the sellers, because they enabled them to offset interest-rate risk that they had accrued elsewhere.

In Italy the problem seems to have been just as widespread. Some estimate that as many as 600 Italian town councils could lose money on derivatives. And in neighbouring Austria the state-owned railway said on April 29th that it had made a loss of almost €1 billion, partly because of a €420m write-down on complex credit derivatives bought from Deutsche Bank in 2005. Bloomberg reported that the railway is appealing against a court judgment in February dismissing the claim that the lender did not disclose the risks.

Given the scale of the losses that are emerging, more such deals will probably end up in court. In America

Jefferson County in Alabama is suing JPMorgan Chase for allegedly mis-selling credit derivatives. In most cases, buyers of credit derivatives will claim they were victims. In the case of public bodies, at least, voters should reserve judgment. For such claims to succeed, the officials who agreed to the deals will have to testify convincingly that they had no idea what they were doing. As Milan's elders must be uneasily aware, the price they may have to pay for victory in court could be their jobs in the council.

Economics focus

New fund, old fundamentals

Apr 30th 2009
From The Economist print edition

Has the IMF changed? Or has the world?

BY ANY standards, $500 billion is an impressive birthday present. The IMF's managing director, Dominique Strauss-Kahn, turned 60 on April 25th, the same day the fund's steering committee gave its blessing to a proposed tripling of the institution's resources from $250 billion to $750 billion. As the birthday boy is fond of saying: "The IMF is back."

But it is back in a new guise. The IMF is notorious for favouring hard money and tight budgets. The new fund ("IMF 2.0" as *Time* magazine called it) believes in casual Fridays and Keynesian policies. Since January 2008, Mr Strauss-Kahn has urged the world's biggest economies to loosen their belts. And fiscal stimulus is not just for rich countries, he said at the spring meetings last week. Poor, well-run countries like Tanzania should also try it.

He also referred to a new position note* by Atish Ghosh and four other IMF economists, laying out the options for emerging markets in the global crisis. Those include monetary easing as well as fiscal stimulus and "heterodox" debt workouts. "We really are in new times, no?" the managing director said. "I like this." His comments raise a further question: do the different prescriptions reflect a new fund or new times?

In the Asian financial crisis, the IMF supported punishingly high interest rates to defend the region's currencies and combat inflation. Real rates in Indonesia topped 49% in August 1997 (even before the fund arrived). The aim was to bludgeon speculators and impress creditors. The obvious alternative was to abandon the fight and let the currency fall. That would free the central bank to cut rates. Unfortunately, it would also bankrupt any firms or banks that had borrowed heavily in foreign currency in the belief that the traditional parities were sacrosanct.

More than ten years on, the wisdom of the fund's strategy is still in dispute. (If an economy carries a lot of short-term debt, high interest rates may wreak such havoc that the exchange rate collapses anyway.) But whatever its merits during the Asian financial crisis, the high-rate defence has little appeal today. The benefits of tight monetary policy are more doubtful, and the damaging side-effects of depreciation less severe.

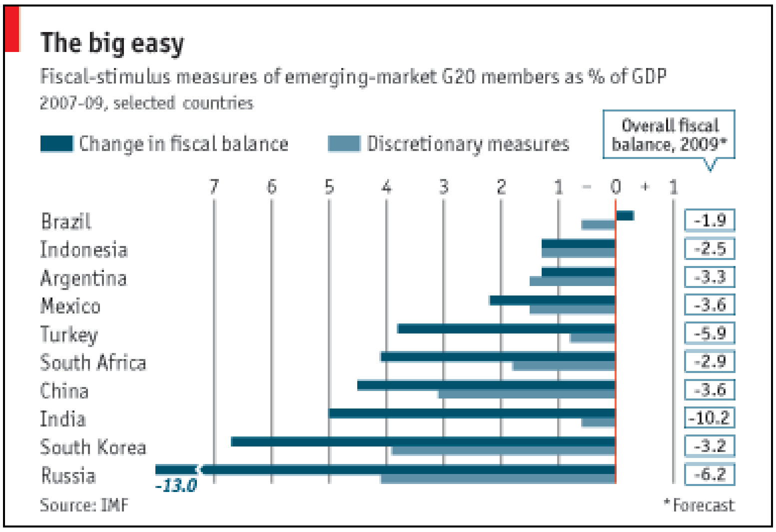
This is because today's crisis originates with rich-world lenders, not emerging-market borrowers, as Mr Ghosh and his co-authors point out. Gripped by the urgent need to raise cash, foreigners have sold whatever assets they can. Often, they have sold most enthusiastically in emerging markets that are deep, liquid and easily exited. Raising interest rates a few points is unlikely to tempt them back. Besides, the rate gap between emerging markets and America's Federal Reserve is already wider now than it was a year or two ago.

Most emerging economies now allow their currencies some freedom of movement. In Latin America and Asia, they have also worked hard to contain currency mismatches, borrowing wherever possible in their own currencies, rather than someone else's. As a result, exchange rates can fall without upending their balance-sheets.

The exception is emerging Europe, which is, in many ways, reliving the Asian financial crisis. Households and companies have borrowed in hard currencies, believing that their exchange rates could only harden against the euro in advance of joining it. For these countries Mr Ghosh and his co-authors advocate debt restructuring in advance of monetary easing. (The IMF has also recommended a swift entry to the euro.) But otherwise, their macroeconomic prescriptions are very IMF 1.0: if a parity is to be defended, high rates will be needed. And even if the parity is abandoned, high rates may still be needed to escape an "inflation-depreciation spiral".

What about fiscal stimulus? In December 1997 the IMF asked South Korea to tighten its belt a notch (a fiscal improvement of 0.4% of GDP). That is now widely seen as a mistake. However, the fund learnt that

lesson within a month, urging the Koreans to ignore the fund's own fiscal conditions. As Jonathan Ostry, one of the paper's authors, points out, the fund now appreciates that fiscal retrenchment does little to restore confidence unless there is an underlying fiscal problem.



Where a country has fiscal room for manoeuvre, it should by all means use it, the IMF argues. Mr Strauss-Kahn has welcomed the pronounced fiscal easing undertaken by the world's biggest emerging markets (see chart).

In principle, a dollar of government spending can raise output by more than a dollar if it stimulates resources that might otherwise lie idle. Public investment might also yield rich returns in countries short of infrastructure. But most studies show that fiscal multipliers are small in emerging economies, especially over the medium term. In some cases, they are negative.

As the authors are keen to point out, a fiscal stimulus can do more harm than good if it jeopardises the sustainability of the public finances. Governments need a credible plan to set aside enough resources in the future to repay the additional public debt their stimulus has added. As Willem Buiter of the London School of Economics puts it, only fiscal conservatives can use counter-cyclical fiscal policy well.

A textbook case

So how much has the IMF's thinking really evolved? Its economics is now overseen by Olivier Blanchard, on leave from the Massachusetts Institute of Technology. In the 1990s the fund's most prominent economist was Stanley Fischer, now governor of Israel's central bank. Each has written a seminal graduate textbook. So whose text do fund economists now turn to for guidance? The answer is easy: both. They are one and the same textbook: "Lectures on Macroeconomics" (1989) by O. Blanchard and S. Fischer. Perhaps the IMF will not be so different after all.

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* "Coping with the crisis: policy options for emerging market countries". IMF staff position note, April 23rd 2009. Available at: www.imf.org/external/pubs/ft/spn/2009/spn0908.pdf

Correction: Ms Hyunyoung Choi

Apr 30th 2009
From The Economist print edition

In an article on April 18th entitled “Googling the future”, we mistakenly referred to Ms Hyunyoung Choi as Mr Choi. We apologise. This has been corrected online.

Warfare

All at sea

Apr 30th 2009
From The Economist print edition

Foreign military bases have both political and practical difficulties. “Seabasing” may offer a solution

Illustration by David Simonds

BASING troops and equipment on foreign soil is fraught with difficulty. Even friendly countries can cut up rough at crucial moments, as America found when Turkey restricted the use of its territory and airspace during the invasion of Iraq in 2003. In an occupied country the situation is worse, as a base is a magnet for attacks. Nor can you always put your base where you need it. If a country does not want to host it, and cannot be bribed to, that—short of invasion—is that.

But no one owns the high seas, and partisans rarely have access to serious naval power. So America, still the world’s only superpower and thus the one with most need for foreign bases, is investigating the idea of building military bases on the ocean. They would, in effect, be composed of parts that can be rearranged like giant Lego bricks. The armed forces could assemble them when needed, add to them, subtract from them and eventually dismantle them when they are no longer required—and all without leaving a trace.

Constructing such bases is a formidable technological challenge. Not only do you have to provide quarters for servicemen, but you also have to handle, store and retrieve large amounts of supplies and weapons without access to dockside cranes. Shuffling the containers carrying these, so that those needed immediately are accessible, is akin to solving a moving-block puzzle where the blocks weigh many tonnes each. But America seems committed to the idea, and the first seabases should be deployable within a decade.

Basic thinking

The original approach to seabasing was extremely Legolike. Modular rafts—platforms mounted on pontoons—would be linked together by hinges to create large, flattish surfaces that could nevertheless bend with the waves. Such a system was tested in a peacetime operation off the coast of Liberia in spring

2008. Instead of armaments, hospital supplies and the materials to build a school were unloaded from a ship to the platform, and thence to landing craft which disgorged them onto a beach.

The experiment worked, but there are doubts about taking it any further. One question is how such a raft of rafts would stand up to severe weather. There is also scepticism about whether the original goal, a surface large enough to create a floating runway that could accommodate transport aircraft, is either financially or physically feasible. It would be far larger than the largest aircraft-carrier now afloat, and thus expensive to build, and it would have to be both rigid and stable enough to act as a runway and flexible enough to withstand rough seas. The difficulty of squaring these requirements has led designers to abandon the idea of strict modularity in favour of a system that uses an array of more conventional but still specially designed ships. According to Robert Button, a seabasing expert at the RAND Corporation, a think-tank, America's navy plans to build 35 ships designed for seabasing over the next decade.

The core of such a ship-based seabase would be something known, in the strangulated jargon beloved of military men, as the Maritime Pre-Positioning Force (Future). America's marines already use pre-positioning supply ships as floating warehouses. The 14 ships in the new replacement class will continue to store supplies in this way. But, in addition, they will have room to berth 2,000 servicemen, or between 20 and 30 vertical-take-off aircraft, or hundreds of ground vehicles. More impressively, each ship will carry a folding bridge, about 30 metres long, to connect it to its neighbour. These bridges—regarded as the linchpins of seabasing—will remain stable in swells of up to 2 metres. They will allow vehicles the size of lorries to drive from one ship to another.

A second element of this form of seabasing is the "mobile landing platform" (MLP), a ship longer than two football pitches, with a large, flat platform. This will make it easier for other vessels, including pre-positioning ships, to load the MLP at sea using cranes and bridges. It will accommodate almost 1,500 servicemen, and ferry them to combat zones along with at least six small landing craft or hovercraft, numerous tanks and lorries, and a small number of vertical-take-off aircraft. One feature of an MLP will be that it can partially submerge itself by pumping water into tanks within its hull. Hovercraft will therefore be able to embark and disembark easily. And a modern hovercraft can carry an Abrams tank, America's heaviest, at a speed of 40 knots.

The cleverest part of a new type of seabase, though, is the mundane matter of having a place for everything, and everything in its place. Most of the stuff on the base will be kept in standard shipping containers until required. War being war, though, it is not always obvious in advance what will be needed when. And if you find that some crucial piece of equipment is in the middle of the bottom of a stack rather than the edge of the top, and you need it in a hurry, you have a problem.

Logistics, logistics, logistics

To deal with this geometric puzzle the defence department paid BEC Industries, an engineering firm based in Florida, to design a special container-management system. The firm completed this system, known as GRID, in February.

In essence, GRID is a way of unburying containers. A winch shuttles back and forth, and side to side, on a grid of rails above stacks of containers. The equipment works rapidly, repositioning half a dozen containers in ten minutes. (A traditional crane might move that many in an hour.) Software determines the most efficient way to rearrange them. Removing just two dozen containers from stacks aligned in rows can involve hundreds of repositionings. Each decision about which container to move next, and where to place it, has implications for the number of times all the other containers must be moved later. According to Brian Pfeifer, the project's chief engineer, working out the shuffling logic was the most complex part of the project. The first example of GRID will be installed on a warship this year.

Cranes will still be needed, though, to load the pre-positioning ships from supply vessels. That is always going to be tricky in anything other than a dead calm. As Ed May, a crane expert at Oceaneering International, an engineering company based in Houston, Texas, observes, the trick is for the crane operator to wait until the ships' movements position the load over the right spot, and then "set it down real quick". Or, in non-technical jargon, drop it.

Dropping it accurately may also be easier in the future. By measuring the motions of nearby waves and vessels with radar and lasers, the software running a crane can predict exactly how a ship will be pushed, and react accordingly. A crane developed by America's Office of Naval Research (ONR) in collaboration with Oceaneering and Siemens, a German industrial giant, automatically adjusts its position to compensate for ship movements the moment they begin. The ONR will test the system at sea this

autumn.

“Logistics, logistics, logistics” is a mantra of seabasing. It is, perhaps, a less catchy slogan than “shock and awe”. But warfare—or even a formidable threat to attack—begins with the movement and stationing of troops and kit. If you can bring your own base with you, that threat is more credible and easier to make.

Psychology

Life in thin slices

Apr 30th 2009
From The Economist print edition

An ancient smile may predict a modern divorce

A GRIM expression in a yearbook photo or family snapshot could mean more than just a passing bad mood. It could also signal that the subject is more likely to get divorced than someone with a big smile for the camera. Matthew Hertenstein and his colleagues at DePauw University in Greencastle, Indiana asked old boys and girls of the university to answer questions about their current sexual relationships and whether they had ever been divorced. The team then looked up pictures of their volunteers in the university's yearbooks and graded the degree of their smiles. The less a person smiled, it turned out, the more likely he or she was to have been divorced over the course of a lifetime.

This research is a dramatic example of how "thin slices" of information can predict important aspects of people's personalities. In past studies, researchers have shown that with very limited information—less than half a minute of interaction, the viewing of a video clip or just a look at a photograph—people can make accurate predictions about others' sexual orientation, socioeconomic status, teaching ability and personality.

Dr Hertenstein was following up research which had shown that the women who smiled most in their college photos were most likely to be married by the age of 27, among other things. He wanted to see if the same held, over the longer term, for divorce. His study, to be published in *Motivation & Emotion*, looked at three groups. The first, of 306 people, came from alumni of the psychology department. The second group, of 349, was recruited from general alumni. The third, of 55 people, was recruited from the town. (In the last case, people were asked to send in photos of themselves, but were not told that the study was about smiling.) The researchers rated the photos of the subjects on a scale of two to ten. They also asked their volunteers various questions, including whether they had ever been divorced.

The relationship between smiling and divorce also held up among townspeople, even though many sent photographs of themselves as children. Facial expression predicted divorce even when the smile or frown was on a ten-year-old's face. A photograph that records a split second from a lifetime is a very thin slice indeed. How could it predict a divorce decades in the future?

The researchers suggest that the smiles are accurate indicators of personality. The results should not be overstretched. The never-divorced had their smiles rated on average at 5.9, 5.9 and 5.2 out of 10 in each of the three groups, while the divorced scored 5, 5.3 and 4.4. That is not a huge difference, but it is statistically significant. On the other hand, comparing only the lowest-scoring people with the highest-scoring, the least-smiling were three times more likely than the biggest smilers to divorce.

Until the findings are replicated it is probably too early to choose a spouse based on a facial expression in a photo. On the other hand, it would not hurt to smile for the camera yourself.

Civil engineering

Filling in the cracks

Apr 30th 2009
From The Economist print edition

How to preserve concrete with bacteria

CONCRETE is one of the most commonly used building materials. It is cheap, strong and easy to work with. But, as a short walk through any city centre will prove, it cracks easily. The cracking of concrete pavements is merely a nuisance, but cracks in roads, bridges and buildings are a hazard. A way of making concrete that healed such cracks spontaneously would thus be very welcome. And a team led by Henk Jonkers at the Delft University of Technology in the Netherlands may have come up with one.

The way to stop concrete cracking is to bung up small cracks before they enlarge. That process of enlargement is caused by water getting into a crack, then freezing in cold weather and thus expanding. This freeze-thaw cycle, a common form of erosion of natural rocks, too, weakens a structure directly and also exposes steel reinforcing rods to water, causing them to rust.

When he began his research, Dr Jonkers knew that spraying mineral-producing bacteria onto limestone monuments is often an effective way to stop freeze-thaw in its tracks. The mineral in question is calcium carbonate, the defining ingredient of limestone. He also knew, however, that when applied to concrete, this technique had proved to be just as time-consuming and, indeed, more expensive than traditional repair methods using sticky, water-repellent agents. That led him to wonder if the answer was to incorporate helpful bacteria into concrete from the start.

To find out, he and his team selected various mineral-producing bacterial strains that can handle the highly alkaline environment found in liquid concrete. They added these bacteria, along with calcium lactate, an organic compound that such bacteria convert to calcium carbonate, to different samples and allowed those samples to set. At various intervals, the team powdered the solidified samples, created cultures to test for living bacteria, and ran calculations to determine the number of bacterial cells that had survived solidification. They also examined samples of the concrete for microscopic cracks and to see which minerals had formed.

As they report in *Ecological Engineering*, Dr Jonkers and his team found that the mineral grains which formed in the cracks of samples of concrete that had been seeded with bacteria were often as large as 80 microns across. That would go a long way towards sealing those cracks and making them waterproof. The equivalent grains in control samples were rarely larger than 5 microns across.

Unfortunately, this study also showed that the bacteria survive for only a few weeks. Beyond that period, the concrete fails to heal. But data from a second study, as yet unpublished, suggest that immobilising the bacteria in particles of clay before they are added to the concrete allows them to live for months, and possibly years. The clay serves both as reservoir for the bacterial food and also as a haven for the bacteria while the concrete hardens. If the process can be scaled up, it may be prove that the best way to preserve concrete is to infect it.

Animal behaviour

Snowball fight

Apr 30th 2009
From The Economist print edition

Everybody knows that birds sing. But it appears that some can dance, too.

SNOWBALL is probably the world's most famous living parrot, with a Wikipedia entry to prove it. One clip of him on YouTube, a video-sharing website, has had over 2m hits. The sulphur-crested cockatoo's claim to stardom is his ability to perform what looks decidedly like dancing (to the Backstreet Boys' hit, "Everybody"). It is an intriguing display but an aberrant one, as parrots have never been seen to dance in the wild. Nevertheless it may, according to Aniruddh Patel of the Neurosciences Institute in San Diego, shed light on the evolutionary origins of song and dance in people, too.

There are three main theories of the origins of singing and dancing. Two suggest they are functional—either serving to attract mates or fostering social cohesion and thus collaboration. The third, put forward recently by Dr Patel, says the whole thing is a glorious accident—the by-product of an evolved capacity for mimicking vocal cues, which humans have because that is how they learn to speak. This is a plausible explanation of singing, but how it might then lead to dancing (ie, a rhythmic movement of various parts of the body in time to the music) is obscure. Nevertheless, one possible test of Dr Patel's hypothesis is to see if anything resembling dancing emerges in animals known to be vocal mimics, who are exposed to the rhythms of human music.

Dr Patel and his team have thus taken a close interest in Snowball, who has been residing at the Bird Lovers Only Rescue Service in Schererville, Indiana, since he was left there by his previous owners in 2007, along with a CD of his favourite music. The results of their research have just been published in *Current Biology*.

Their conclusion, after sophisticated statistical analysis to exclude the possibility of coincidence, is that Snowball really is dancing. If a song's tempo is changed without changing its pitch, his head-bobbing and leg-lifting change time to match. And they are not alone in this conclusion. Adena Schachner of Harvard University and her colleagues have also been studying this psittacine prodigy and they, too, have just published their findings in *Current Biology*.

www.youtube.com

Shake it all about

Broadly, they endorse Dr Patel's conclusion that Snowball is jiving to the beat. They have also found a similarly talented African grey parrot, and conducted the same experiments on that. But they went further than Dr Patel by trying to persuade cotton-top tamarins, a species of monkey, to learn to dance as well. They failed, as Dr Patel's theory predicted they would, because tamarins—although very vocal—are not mimics.

Further investigation on YouTube, by Dr Schachner, has turned up 33 video clips of animals with Snowball-like talents. All told, there are 14 types of parrot in these video clips, all species well-known for vocal mimicry, and one elephant. That elephants are vocal mimics is less widely known, but it has recently been established scientifically.

Whether any of this truly endorses Dr Patel's hypothesis is moot. Since none of the species looked at is known to dance in the wild, and all are known vocal mimics, it does suggest that vocal mimicry somehow provokes dance-like behaviour when an individual is exposed to a rhythmic sound. But, though there is no disputing Snowball's talent, that is not proof.

Apology: Lighting up cancer

Apr 30th 2009
From The Economist print edition

We would like to apologise to the world's pathologists for suggesting that the histological examination of excised tumours is carried out by "technicians", as suggested last week in "Illuminating surgery". The pathologists who perform this work are of course, physicians who specialise in the examination of tissue samples.

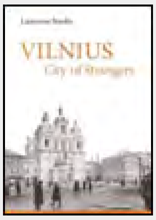
Vilnius

Contested city

Apr 30th 2009
From The Economist print edition

Vilnius is an example to others—a contested city, but not a divided one

Vilnius: City of Strangers
By Laimonas Briedis



Baltos Lankos/CEU Press; 296 pages; $45 and £24.95

Buy it at
Amazon.com
Amazon.co.uk

Alamy

THE choice of name for the capital of present-day Lithuania—Wilno, Vilna, Vilne, Wilda, Vilnia or now Vilnius—shows who you are, or were. In the 20th century alone, it has been occupied or claimed by Germany, Russia, Poland and the Soviet Union, with only brief periods of Lithuanian autonomy.

Vilne, in Yiddish, was home to one of Judaism's greatest rabbis, a saintly brainbox known as the Gaon (Genius) who gave his first sermon aged seven and kick-started the great Jewish intellectual revival in the 18th century. "Vilna is not simply a city, it is an idea," said a speaker at a Yiddish conference in 1930. It was the virtual capital of what some call Yiddishland, a borderless realm of east European Jewish life and letters in the inter-war era. At times, the majority of the city's population was Jewish. Their murder and the deportation of many Poles by Stalin meant that the city lost 90% of its population during the second world war. Present-day inhabitants of Vilnius may find much they did not know in Laimonas Briedis's subtle and evocative book about their city's history.

Poles mourn the loss of Wilno, one of their country's great cultural and literary centres. Poland's two great poets studied there: Adam Mickiewicz nearly two centuries ago, and in the pre-war years Czeslaw Milosz, a Nobel prizewinner. Yet both men saw their Lithuanian and Polish identities as complementary, not clashing.

For Russians, Vilna had harsher echoes. Fyodor Dostoyevsky stayed there briefly, detesting the subversive pro-Polish sentiment of what was the third-largest city in the tsarist empire. Earlier it was centre stage in Napoleon's disastrous invasion of 1812. Mr Briedis neatly sums up the city's appearance in Tolstoy's "War and Peace". "A crossing through Vilna was like a passage of honour: to the east…lay Russia—a familiar land offering spiritual comfort and self-respect; to the west—Europe—a foreign territory prompting national self-doubt and embarrassment."

In any of the dozen possible renderings of the city's name, its roots evoke mystery. Wilda, its old German label, comes from the word wild. In Lithuanian come hints of the words for devil (*velnias*), the departed (*velionis*) and ghost (*vele*). That ambiguity is fitting. In its 700-odd years of recorded history, the city has been both capital city and provincial backwater. Outsiders have been struck by its filthy streets and shameless women, and also by its glorious architecture and heights of scholarship. Pilgrims flock to the Gates of Dawn (its towers pictured above), its most holy Catholic shrine. It has been the epitome of tolerance and a crucible of the Holocaust.

In a modern Europe Vilnius can seem peripheral. Mr Briedis, however, begins by noting that when French geographers recently plotted the mid-point between Europe's cartographical extremes, they found the continent's true centre was a derelict farmhouse just outside the city.

Foreign visitors have left few written accounts, but Mr Briedis uses them all as sources. A hapless papal delegation provides the first. In 1324 it tried and failed to persuade Lithuania's great pagan ruler, Gediminas, to adopt Christianity. He showed no desire to forsake Perkunas the thunder god, berating his visitors for their intolerance. "Why do you always talk about Christian love?" he asked the pope's men. "Where do you find so much misery, injustice, violence, sin and greed, if not among the Christians?"

Lithuania eventually adopted Christianity, along with a dynastic deal with Poland, in 1387. A cathedral was built on the pagan temple, the holy fires doused and the sacred groves felled. The Grand Duchy of Lithuania flourished. At its height in the 16th century it was a vast multiconfessional empire, stretching to the Black Sea, with no fewer than six legal languages, including Hebrew and Armenian. Even as that declined, the Vilnius style of Baroque architecture ripened in glory, a "splendid autumn" in one of Mr Briedis's many well-turned phrases, that paid "a gracious farewell to its phantom golden age".

The most poignant chapter is on cemeteries past and present, many of which were desecrated by the Soviets. Mass graves are still unearthed in Vilnius. They hold victims of Stalin's NKVD, of the Nazis, and—as in one recent example—thousands of fallen soldiers from Napoleon's shattered Grande Armée. Vanished civilisations and lost empires leave a city stalked by horror and steeped in wonder.

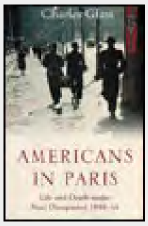
Vilnius: City of Strangers.
By Laimonas Briedis.
Baltos Lankos/CEU Press; 296 pages; $45 and £24.95

Americans in Paris

Treachery and heroics

Apr 30th 2009
From The Economist print edition

Americans in Paris: Life and Death Under Nazi Occupation 1940-44
By Charles Glass



Harper Press; 524 pages; £20

Buy it at Amazon.co.uk

WHEN Hitler's tanks rolled into Paris on June 14th 1940, the city's American residents (perhaps 5,000) were officially safe, protected by an American neutrality that was to last another 18 months. But none in Paris could remain unaffected. Some fled, either to the unoccupied zone of Vichy France or abroad. By the spring of 1941 around 2,000 had chosen to stay—and they are the subject of this engrossing book by Charles Glass. They range from Sylvia Beach, the lesbian owner of the Shakespeare and Company bookshop on the left bank, determined to desert neither her customers nor her lover, to the courageous Dr Sumner Jackson of the American Hospital in Neuilly.

Mr Glass, an American journalist who has hitherto specialised in the Middle East, sensibly does not generalise. Instead, by concentrating on a handful of his compatriots, he sketches in the complexities, moral, political and practical, that assailed American expatriates as Paris moved from the comfort of the "phoney war" to the privations of the real war. Count Aldebert de Chambrun, born in Washington, DC, and a direct descendant of General Lafayette, was instrumental in keeping the American Hospital functioning. His wife Clara, whose brother was President Roosevelt's son-in-law, administered the American library. His son René spent months in America seeking military aid for France and Britain. Yet by the end of the war the aristocratic Chambruns (Clara was the ultimate snob) were derided by many as collaborators. After all, René was married to the daughter of Pierre Laval, the Vichy France prime minister, and Clara had made no attempt to hide her sympathy for Vichy's president, General Pétain, and disdain for the leader of the Free French, Charles de Gaulle.

Much more ambiguous was the role of Charles Bedaux, a French-born naturalised American with a string of mistresses and a devoted American wife. Bedaux rose from a poor-boy youth spent around the brothels of Montmartre to become a millionaire industrialist with his own "Bedaux system" to allow the "proper use of manpower for faster output with fewer men". Mr Glass produces plenty of evidence for Bedaux's American patriotism, but his weakness was his willingness to talk business with everyone, including both Vichy and the Nazis. So did he deserve his subsequent arrest in America, and the charge of treason? Quite possibly not, but the despairing Bedaux cheated the courts by committing suicide.

By contrast, no one could doubt the heroism of Sumner Jackson, who from the very beginning resisted the occupation by hiding British and American servicemen in the American Hospital and then organising their escape. Jackson's wife and son also joined the resistance, and both survived their eventual imprisonment by the retreating Germans. Sadly, Jackson did not. He was presumed drowned when the RAF bombed his prison ship just five days before Germany's surrender.

Such stories would be interesting in their own right. The extra value that Mr Glass brings is to insert them seamlessly into the context of international diplomacy and the history of the war. He also draws attention to something too often forgotten: America's racial prejudice. Eugene Bullard, for example, was brave enough to fight in the French Foreign Legion, to fly for France and to be awarded the Légion d'Honneur and the Croix de Guerre. But as a black man he was excluded from the American Army Air Corps. As Mr Glass notes, America gave the honour of liberating Paris to French troops—but made sure none was black. As General Eisenhower's chief of staff put it: "It is highly desirable that the [French] division should be composed of white personnel." Liberty, yes, but not exactly the equality promised by the French Republic.

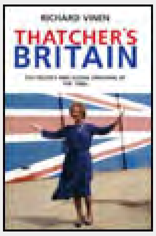
Americans in Paris: Life and Death Under Nazi Occupation 1940-44.
By Charles Glass.
Harper Press; 524 pages; £20

Thatcher's Britain

Passing the baton

Apr 30th 2009
From The Economist print edition

Thatcher's Britain: The Politics and Social Upheaval of the Thatcher Era
By Richard Vinen



Simon & Schuster; 416 pages; £20

Buy it at Amazon.co.uk

SOME young Britons who will vote in a general election for the first time next year were not born when Margaret Thatcher was ousted from office. Yet, for better or worse, something called "Thatcherism" still provides much of the context of British politics as it limps towards the second decade of the 21st century. It is to that generation that Richard Vinen has primarily addressed this account of the momentous political and social changes overseen by the Thatcher governments of the 1980s. His purpose is to explain Lady Thatcher's real and continuing significance to readers who may see her as an indistinct if mythic figure from a distant past, while at the same time rooting what she did firmly in the circumstances of her own time.

Lady Thatcher, who on May 4th marks the 30th anniversary of her ascent to power, remains a towering, if spectral, presence. That is not in doubt. In accepting the irreversibility of much of her legacy, both Tony Blair and Gordon Brown defined New Labour in explicitly post-Thatcherite terms. Paradoxically, when David Cameron and his small group of modernisers seized control of the Tory party just over three years ago, they believed that weaning it from its infatuation with some of Thatcherism's harsher themes was a necessary condition of electoral revival.

But in recent months, as the plight of the economy has grown ever more desperate, both parties have reversed themselves again. Mr Brown is eager to contrast his activism in mitigating the worst effects of the downturn with the brutal indifference of the Thatcher government during the recession of 1980-82. For his part, Mr Cameron increasingly harks back to that period as a time when the foundations of national recovery were laid by Mrs Thatcher's courageous consistency of purpose.

After a well-publicised dinner with the former prime minister in February, Mr Cameron said: "You have got to do the right thing even if it is painful. Don't trim or track all over the place. Set your course and take the difficult decisions because that is what needs to be done…I think that influence, that character she had, that conviction she had, I think that will be very important." Maggie's mantle, if not her words.

Thatcher's Britain: The Politics and Social Upheaval of the Thatcher Era.
By Richard Vinen.
Simon & Schuster; 416 pages; £20

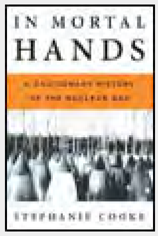
The nuclear age

Cautionary tales

Apr 30th 2009
From The Economist print edition

EACH generation is condemned to grapple anew with the possibilities and perils of splitting the atom and destroying humanity. Assuming a predicted "nuclear renaissance" survives the economic downturn, will nuclear power one day be so developed that it fulfils its promise by helping to save the planet from climate-change disaster? Can the other sort of apocalypse be more safely averted by "getting to zero", banning the bomb even as knowledge to build it spreads?

In Mortal Hands: A Cautionary History of the Nuclear Age
By Stephanie Cooke



Bloomsbury; 487 pages; $27

Buy it at
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Illustration by Daniel Pudles

Nuclear debates are seldom well-informed, whether on the streets, in the media or in cabinet rooms. Scientists use off-putting jargon. Politicians do not bother to know enough to ask the right questions. Stephanie Cooke, an American writer, has done them all a favour. Her command of the diplomatic detail is just occasionally less sure (for example, the Start-2 arms-cutting treaty between America and Russia never actually came into effect). But this is an otherwise highly readable tale of the atom's problems and possibilities, blending the author's scientific and technical fluency with the human stories, achievements and doubts of those who built the bomb, and those who later hoped to tap the civilian benefits of nuclear power. What emerges is a cycle of expectation, breakthrough, mishap and false promises. Unless better understood, it is in danger of being repeated.

Only the few who had worked on the Manhattan project truly understood the implications of their fearsome creation, as they raced to beat Nazi Germany to the bomb. Even then, some looked for silver linings in the mushroom clouds from Hiroshima and Nagasaki that brought the second world war to a halt. Such weapons must surely mean an end to all war, some thought, and the advent of peace.

It did not turn out that way. The secrets of the bomb started leaking virtually from the outset, as they continue to do today. Safeguards could anyway never be watertight. Indeed, those who rest their hopes today on technical fixes to get safely to a nuclear-free world are the wrong sort of dreamers. Meanwhile, proposals for international control of the atom, including a fuel bank, an idea suddenly back in vogue, fell victim to competition, suspicion and, between America and the Soviet Union at least, an emerging cold war.

The expectation of electricity "too cheap to meter" brought hopes in some quarters of an end to world poverty. Yet nuclear power proved costly and far from risk-free. Some presumed that by the turn of the 20th century there could be more than 500 fast-breeder reactors, fuelled by expanding stockpiles of plutonium. By the millennium's end not a single fast-breeder was in commercial operation (the necessary experimental forerunners produce plutonium in quantities useful for bomb-making). The Bush administration's Global Nuclear Energy Partnership sought to revive the breeder idea (renaming it a fast-

burner), but plans had to be shrunk due to cost, technological complexity and the danger of proliferation.

Whatever the nuclear technology used, the by-products thus far have been accidents (Three Mile Island and Chernobyl were among the worst but there have been plenty of others), pollution and piles of nuclear waste. Meanwhile technologies and materials acquired to keep the lights on can be misused in weapons.

Spread around generously in the 1950s and 1960s, “atoms for peace” helped get Argentina, Brazil, India, Israel, Pakistan, South Africa, South Korea, Taiwan and others started in the bomb business. (Other secretive programmes—in Iran, Libya, North Korea—thrived mostly on black-market connections.) Now, once again, nuclear suppliers are signing up governments with nuclear ambitions, arguing that co-operation will help ensure the technology is put to proper use. But history suggests that no one can be sure where all this will lead.

In Mortal Hands: A Cautionary History of the Nuclear Age.
By Stephanie Cooke.
Bloomsbury; 487 pages; $27

Impressionist painting

Manet, Monet, money

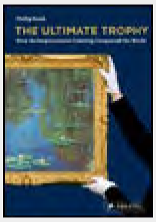
Apr 30th 2009
From The Economist print edition

IN THE early 1870s a new school of painting was exhibited in Paris. Its exponents were known in its early days as Naturalists or even Intransigents, before settling into the label by which they have become known today: Impressionists.

By attempting a new way of painting light and its effects, so that it "palpitates with movement, light and life", Stéphane Mallarmé, a 19th-century French poet, explained that Impressionism boldly turned its face away from the precise photographic finish of French academic art of the second half of the 19th century.

At first few understood what Edouard Manet, an Impressionist artist, and his followers were trying to do. Emile Zola in his 1886 novel, "The Masterpiece", described the horror felt by much of the general public when they saw the pictures in the first avant-garde exhibitions. "That novel rendering of light seemed an insult to them. Some old gentlemen shook their sticks."

The Ultimate Trophy: How the Impressionist Painting Conquered the World
By Philip Hook



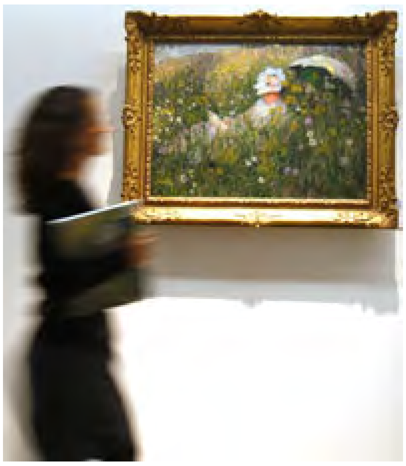
Prestel; 224 pages; $29.95 and £17.99

In this delightfully readable book, Philip Hook, Sotheby's senior director of Impressionist and modern art, analyses how the rebellion took different forms in different countries. But what it had in common everywhere was the younger generation's desire to cleanse artistic vision by painting only what they saw about them, with broad brushstrokes and brighter, simpler colours. Many of the Impressionists eschewed black, for example, conscious that shadow was actually composed of other colours, mostly purples and blues.

Impressionism's dissolution of form into colour and atmosphere was an alarming development for the conservative bourgeoisie. The earliest buyers tended to be the artists' friends, men of modest means such as Paul Gachet, Vincent van Gogh's homeopathic doctor, and Pierre-Auguste Renoir's friendly customs officer, Victor Choquet. But what began as rebellion soon became the new fashion. Those who bought Impressionist works directly from the artists were crushed by a stampede of American millionaires and the new industrial aristocracy from France, Britain, Germany and Russia. On hand to reassure the newly moneyed about their purchases was a creature that had not been seen before, the art dealer—men such as Paul Durand-Ruel, who helped turn the patronage of artists into the commercialised market familiar today.

Rich industrialists gave way in the 1950s to such buyers as Stavros Niarchos, a Greek shipowner, and William Somerset Maugham, a British novelist and short-story writer then at the height of his fame, and in later decades to the Japanese and now the Qataris. Mr Hook is especially good at describing how the post-war directors of Sotheby's (the less stuffy of the two big auction houses) used a mix of public relations, celebrity journalism and naked opportunism to bring old collections to the market and to the attention of a whole new world of rich buyers. Ten van Goghs appeared in a 1956 biopic of the artist's brief unhappy existence, "Lust for Life", starring Kirk Douglas. Two years later stills from the film were so successful in publicising the sale of the pictures that even the queen herself came to view them at Sotheby's Bond Street saleroom.

AP



This one went to Brunei

Through two successive bull markets Impressionism has been the currency of new money, the gold standard of oligarchs and the international petrocracy who wanted instantly recognisable affirmation of their new enhanced status in the world. The big auctions in New York next week may be quieter than last year's, but demand for the Impressionists will return. Of that Mr Hook is quite certain.

The Ultimate Trophy: How the Impressionist Painting Conquered the World.
By Philip Hook.
Prestel; 224 pages; $29.95 and £17.99

London theatre

Gooldilocks

Apr 30th 2009
From The Economist print edition

A rising star makes his National Theatre debut

RUPERT GOOLD is making up for lost time. As a theatre director in his 20s, he was bringing up a family on £10,000 ($14,600) a year. Now, at 37, he is so much in demand that he contemplates life in the new 50% tax bracket for those earning over £150,000. On May 5th Mr Goold makes his directorial debut at Britain's National Theatre with "Time and the Conways", J.B. Priestley's tantalising play about fate and free will. His revival of the musical "Oliver" is running in the West End. His "King Lear" has just finished, and last year his production of "Macbeth" won three different best-director awards. He was especially pleased that his production of Harold Pinter's "No Man's Land" pleased the playwright not long before his death. In the autumn he directs Puccini's "Turandot" at the English National Opera. Mr Goold is British theatre's man of the moment.

Five years ago, as the artistic director of the Royal & Derngate Theatre in Northampton, he was so anxious for the oxygen of publicity that he developed what he called "event theatre". It meant casting Jane Birkin, celebrated for her sexy singing in the 1960s, as Gertrude in "Hamlet", and transforming the macabre artists, the Chapman Brothers, into characters in his production of Christopher Marlowe's "Dr Faustus". The idea was to attract attention to his work by moving the story off the arts pages and on to the news pages. He has employed this tactic ever since. His "Macbeth" was set amid sinks and stainless steel in an institutional basement, and he encouraged a masterly performance from Patrick Stewart, a Shakespearean actor who went to Hollywood as Captain Picard in "Star Trek". "I believe in entertainment and showmanship," he says. "I'm a Cavalier, not a Roundhead. Look at my hair."

The energetic Mr Goold also runs Headlong Theatre, a production company. "I felt I needed to get hold of the means of production," he says. His stagings of Luigi Pirandello's "Six Characters in Search of an Author", which transferred from Chichester to the West End last summer, and "King Lear" were both co-productions involving Headlong. But the remarkable thing about his work is not just the vivid imagination, it is the quantity. He explains: "If you felt you weren't at the high table for a long time, then you eat a lot when you get there."

The steep upward trajectory of his reputation has not been without the odd blip. Although his "Lear" did excellent business in Liverpool and London, the reviews were mixed, and he had upsetting differences of interpretation with Pete Postlethwaite in the lead role. The phenomenon of event theatre also has its critics. With "Six Characters", it meant a completely revised last act. He and his dramaturg, Ben Power, offer the term "intervention" to describe their work, though Mr Goold has also referred to it as "conceptual buggering about". Perhaps out of respect for the dignity of the National Theatre, he has apparently kept this to a minimum in the Priestley play.

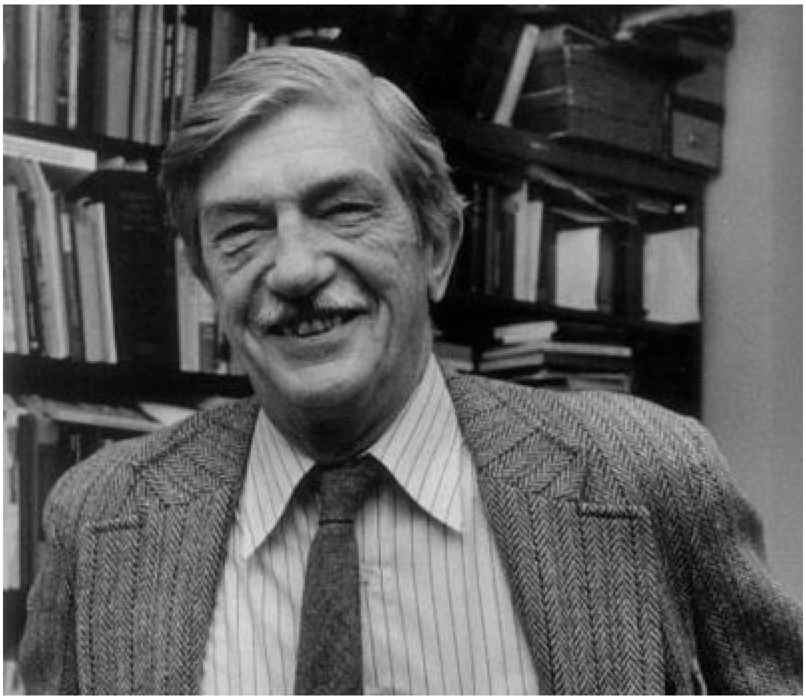
His National Theatre debut comes as speculation has begun about the possibility of Mr Goold being appointed as artistic director of one of the two great national companies. The Royal Shakespeare Company has already appointed him an associate director. His "Tempest", set in the Arctic, was a successful RSC production, and he finds the "varsity fervour" of its Stratford home quite intoxicating. But the high standards at the National still make this the pinnacle of directors' theatre. When he names three directors most likely to succeed Nicholas Hytner, he does not include himself. (His three are Stephen Daldry, Sam Mendes and Michael Grandage.) With a flicker of uncertainty, he speculates that he will be too old when his turn might come round. Whatever happens, Mr Goold is unlikely to return to obscurity. He has been there and he did not like it.

Samuel Beer

Apr 30th 2009
From The Economist print edition

Samuel Beer, Harvard professor of the old school, died on April 7th, aged 97

Harvard University



"You are old, Father William," the young man said,
"And your hair has become very white;
And yet you incessantly stand on your head—
Do you think, at your age, it is right?"
—Lewis Carroll

HIS hair turned no whiter than a pale auburn, and he was never caught standing on his head, but even in his advanced years Sam Beer continued to surprise—by playing the harmonica in bravura style, for example, or by coming 13th in a skydiving competition among 250 contestants half his age. The vitality that sparkled most brightly, though, was that of the mind. When Harvard's grandest political scientists gathered last year to brief alumni on their activities, the former chairman of the department, then a mere 96, was asked to make a few comments about the study of government during his tenure from 1946 to 1982. "He completely stole the show," said one. Speaking without notes, remembering everyone and everything, he upstaged all the incumbent professors.

Mr Beer was a formidable scholar, the author of countless articles and several books. The best of these, "British Politics in the Collectivist Age", picked apart the country in which he had studied before the war and established him as the foremost authority on modern British politics (which was the title of the British edition). He wrote two other books on Britain, one on the Treasury and one on what he called "the decline of civic culture" or, more politely, "the rise of the new populism". He also analysed his own country, notably in a book that examined the creation of the American nation through the twin lenses of history and political theory.

These were the disciplines that most excited Mr Beer, and that he in turn made exciting to his students. And this he did even better than pursuing scholarship. For 30 years undergraduates rolled up in droves to Soc Sci 2, his course on Western thought and institutions, taking them from 12th-century England through the Puritan and French revolutions to the great age of reform in Britain and the Nazi catastrophe. Tall, confident, self-interrogatory, Mr Beer would engage his students in an exercise of argument and counter-argument that might leave them unsure of exactly what he believed, but not of his status as a

professorial superstar.

As it happened, they had probably heard about what he believed. Mr Beer was born in the small Ohio town of Bucyrus, to a family that took both politics and history seriously. His mother had died when he was a child, and he grew up among men who had fought in the civil war; an uncle had been killed in the Spanish-American war. Perhaps sensing that Sam would enjoy an early brush with power, his father took him at the age of ten to meet Warren Harding in the White House. Fifteen years later, after a spell at Balliol College, Oxford, on a Rhodes scholarship, he was working for the Democratic Party in Washington and helping to write speeches for Franklin Roosevelt. He took no credit for any memorable phrases. “In fact, I opposed the ‘rendez-vous with destiny’ speech [FDR’s 1936 acceptance address] because it seemed pretty corny,” he said.

The triumph of teaching

His own war led to a bronze star won in Normandy and a job interviewing defeated Germans. What, he wanted to know, was a good Nazi? Why was there no underground? Back home, political theory regained the upper hand, and he started his long teaching career at Harvard. But he did not give up political practice entirely. From 1959 to 1962 he was chairman of Americans for Democratic Action, a lobbying group unashamed to call itself liberal, in the Rooseveltian sense of politically progressive. He later served on the McGovern-Fraser commission, which was charged with drawing up new delegate-selection rules after the disastrous Democratic convention in Chicago in 1968. The result was the disastrous Democratic convention of 1972.

More satisfying was Mr Beer’s association with the Kennedys. He was a friend of Jack’s and an energetic supporter of Ted’s. But unlike many Harvard professors, including some, such as Henry Kissinger, who had been his students, he never went back to work in Washington.

Mr Beer believed in teaching, as some 10,000 students can attest. In this, as in other matters, he was old-fashioned. He was an American liberal who found much that he liked in European liberalism, whether it was in the theories of T.H. Green, who believed the state had an enabling role to play in a liberal society, or the ideas of Jo Grimond, a Balliol contemporary who led the British Liberal Party 50 years ago. And the proper vehicles for politics, he thought, were parties, not single-issue groups, companies or trade unions. He liked student revolt even less: the classroom was the place to learn about politics, not to engage in it. He lamented the weakening of parties, in both America and Britain. And Parliament also needed strengthening, he believed. It should borrow from the committee system of Congress. Eventually it did.

This was far from his only piece of good sense. Charming, generous and always welcoming to visitors and students, he long harboured a deep suspicion about banks. For a while he had no car, or radio, or bank account. “I didn’t want them to make a dime out of me,” he explained, “so I put my $5 a week in postal savings.”

Overview

Apr 30th 2009
From The Economist print edition

America's GDP shrank at an annualised rate of 6.1% in the first quarter. This was worse than expected, though the pace of decline slowed slightly from the previous quarter's 6.3% plunge. Consumer confidence shot up to 39.2 in April from 26.9 in March, according to the index published by the Conference Board, a business-research firm.

Japan's industrial production rose by 1.6% in the month of March, compared with a fall of 9.4% in February. The rise, the first in six months and twice what had been forecast, is a sign that large cuts in inventories may now have run their course.

Britain's GDP was 1.9% lower in the first quarter of this year than in the last quarter of 2008. The worst decline was in manufacturing, where output fell by 6.2%. However, service-sector output declined by a more modest 1.2%.

Headline consumer price inflation fell marginally in **South Africa**, to 8.5% in March from 8.6% in February.

South Korea's exports fell by 17.8% in the year to March. But a much steeper decline in imports, which fell by 35.8% over the same period, meant that the country's current-account surplus rose to $6.65 billion, from $3.56 billion in February.

Brazil's central bank cut its benchmark interest rate by a percentage point, to 10.25%, and **New Zealand's** central bank cut its benchmark rate by half a percentage point, to 2.5%, both record lows.

Output, prices and jobs

Apr 30th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−2.6 Q1	−6.1	−2.7	+1.4	−12.8 Mar	−0.4 Mar	+4.0	−0.8	8.5 Mar
Japan	−4.3 Q4	−12.1	−6.5	+0.4	−34.2 Mar	−0.1 Feb	+1.0	−1.0	4.4 Feb
China	+6.1 Q1	na	+6.0	+7.0	+8.3 Mar	−1.2 Mar	+8.3	−0.8	9.0 2008
Britain	−4.1 Q1	−7.4	−3.5	+0.3	−12.5 Feb	+2.9 Mar§	+2.5	+1.2	6.7 Feb††
Canada	−0.7 Q4	−3.4	−1.9	+1.6	−7.8 Jan	+1.2 Mar	+1.4	+0.6	8.0 Mar
Euro area	−1.5 Q4	−6.2	−3.4	+0.2	−18.4 Feb	+0.6 Apr	+3.3	+0.4	8.9 Mar
Austria	+0.5 Q4	−0.8	−2.0	+0.3	−14.2 Feb	+0.8 Mar	+3.5	+0.6	4.5 Feb
Belgium	−3.0 Q1	−6.2	−2.7	+0.3	−17.9 Jan	+0.6 Apr	+4.2	+0.7	11.2 Feb‡‡
France	−1.1 Q4	−4.4	−2.7	+0.3	−15.5 Feb	+0.3 Mar	+3.2	+0.3	8.6 Feb
Germany	−1.7 Q4	−8.2	−4.3	+0.3	−20.3 Feb	+0.7 Apr	+2.4	+0.3	8.1 Mar
Greece	+2.4 Q4	+1.2	−3.6	−1.1	−4.6 Feb	+1.3 Mar	+4.4	+0.9	9.4 Jan
Italy	−2.9 Q4	−7.5	−3.7	+0.1	−20.7 Feb	+1.3 Apr	+3.3	+0.8	6.9 Q4
Netherlands	−0.6 Q4	−3.8	−2.7	+0.5	−12.7 Feb	+2.0 Mar	+2.2	+0.9	4.1 Mar††
Spain	−0.7 Q4	−3.8	−3.1	−0.5	−23.9 Feb	−0.1 Mar	+4.5	+0.3	17.4 Mar
Czech Republic	+0.7 Q4	−3.7	−3.0	+1.2	−17.5 Mar	+2.3 Mar	+7.1	+1.8	7.7 Mar
Denmark	−3.7 Q4	−7.3	−3.1	+0.5	−11.3 Feb†††	+1.8 Mar	+3.1	+1.1	2.9 Mar
Hungary	+2.0 Q4	−3.9	−6.0	−1.0	−25.4 Feb	+2.9 Mar	+6.7	+2.8	9.7 Mar††
Norway	+0.8 Q4	+5.6	−2.0	+0.5	−5.1 Feb	+2.5 Mar	+3.2	+1.9	3.1 Feb***
Poland	+2.9 Q4	na	−0.4	+1.8	−14.3 Feb	+3.6 Mar	+4.1	+3.0	11.2 Mar‡‡
Russia	+1.2 Q4	na	−3.0	+2.0	−13.7 Mar	+14.0 Mar	+13.3	+13.8	10.0 Mar‡‡
Sweden	−4.9 Q4	−9.3	−3.6	+0.7	−22.9 Feb	+0.2 Mar	+3.4	−0.1	8.3 Mar‡‡
Switzerland	−0.1 Q4	−1.2	−2.3	+0.1	−6.0 Q4	−0.4 Mar	+2.6	−0.2	3.3 Mar
Turkey	−6.2 Q4	na	−4.4	+1.0	−23.7 Feb	+7.9 Mar	+9.2	+6.8	12.3 Q4‡‡
Australia	+0.3 Q4	−2.1	−0.8	+1.6	−0.7 Q4	+2.5 Q1	+4.2	+2.1	5.7 Mar
Hong Kong	−2.5 Q4	−7.8	−5.9	−0.3	−10.3 Q4	+1.2 Mar	+4.1	+0.9	5.2 Mar††
India	+5.3 Q4	na	+5.0	+6.4	−1.2 Feb	+9.6 Feb	+5.5	+5.9	6.8 2008
Indonesia	+5.2 Q4	na	−1.4	+0.5	−2.4 Feb	+7.9 Mar	+6.3	+4.2	8.4 Aug
Malaysia	+0.1 Q4	na	−3.0	+1.1	−14.6 Feb	+3.5 Mar	+2.8	−0.7	3.0 Q4
Pakistan	+5.8 2008**	na	+0.6	+3.2	−8.9 Jan	+19.1 Mar	+14.1	+9.9	5.6 2007
Singapore	−11.5 Q1	−19.7	−8.8	+0.9	−33.9 Mar	+1.6 Mar	+6.7	+0.1	3.2 Q1
South Korea	−4.3 Q1	+0.2	−5.9	+0.3	−10.6 Mar	+3.9 Mar	+3.9	+0.1	3.7 Mar
Taiwan	−8.4 Q4	na	−6.5	+0.1	−26.0 Mar	−0.1 Mar	+3.9	−1.6	5.7 Mar
Thailand	−4.3 Q4	−22.2	−4.4	+1.4	−15.4 Mar	−0.2 Mar	+5.3	−1.2	2.4 Jan
Argentina	+4.9 Q4	−1.2	−3.0	+1.5	−0.9 Mar	+6.3 Mar	+8.8	+6.2	7.3 Q4‡‡
Brazil	+1.3 Q4	−13.6	−1.5	+2.7	−17.0 Feb	+5.6 Mar	+4.7	+4.4	9.0 Mar‡‡
Chile	+0.2 Q4	−8.3	−0.5	+2.4	−11.5 Feb	+5.0 Mar	+8.5	+3.0	8.5 Feb††‡‡
Colombia	−0.7 Q4	−4.1	−1.0	+1.5	−12.8 Feb	+6.1 Mar	+5.9	+5.4	12.5 Feb‡‡
Mexico	−1.6 Q4	−10.3	−4.4	+1.2	−13.2 Feb	+6.0 Mar	+4.3	+5.0	4.8 Mar‡‡
Venezuela	+3.2 Q4	na	−5.0	−5.4	−0.9 Jan	+28.6 Mar	+29.1	+30.3	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+3.6	+3.7	+7.3 Q3	+12.1 Mar	+14.4	+9.1	8.8 Q4‡‡
Israel	+1.2 Q4	−0.5	−0.8	+2.0	−1.7 Feb	+3.6 Mar	+3.7	+0.7	6.3 Q4
Saudi Arabia	+4.2 2008	na	−1.0	+3.3	na	+6.0 Mar	+8.3	+4.3	na
South Africa	+1.0 Q4	−1.8	−1.8	+3.1	+8.6 Feb	+8.5 Mar	+10.6	+6.0	21.9 Dec‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−9.7 Q4	na	−10.0	−2.5	−29.7 Mar	+2.0 Mar	+10.9	+0.5	8.6 Jan
Finland	−2.4 Q4	−5.0	−5.1	−1.3	−22.8 Feb	+0.9 Mar	+3.9	+0.7	7.6 Mar
Iceland	−1.3 Q4	−3.6	−12.4	−0.9	+0.4 2007	+11.9 Apr	+11.8	+12.5	8.9 Mar‡‡
Ireland	−7.5 Q4	−25.7	−7.3	−2.6	−1.7 Feb	−2.6 Mar	+5.0	−3.5	11.0 Mar
Latvia	−10.3 Q4	na	−15.0	−4.0	−24.2 Feb	+8.2 Mar	+16.7	+2.5	12.3 Jan
Lithuania	−12.6 Q1	−32.9	−8.5	−2.5	na	+7.6 Mar	+11.2	+4.3	9.5 Mar‡‡
Luxembourg	−5.2 Q4	−16.8	−4.0	−0.5	−24.1 Dec	+1.2 Feb	+3.1	+0.5	5.6 Feb‡‡
New Zealand	−2.3 Q4	−2.3	−3.2	+0.7	−0.5 Q3	+3.0 Q1	+3.4	+1.6	4.6 Q4
Peru	+0.2 Feb	na	+2.8	+3.9	−2.7 Jan	+4.8 Mar	+5.5	+4.7	9.4 Feb‡‡
Philippines	+4.5 Q4	+4.1	−1.9	+1.4	−21.1 Feb	+6.4 Mar	+6.4	+1.9	7.7 Q1‡‡
Portugal	−1.8 Q4	−6.2	−4.2	−0.5	−13.7 Feb	−0.4 Mar	+3.1	−1.0	7.8 Q4††
Slovakia	+2.5 Q4	na	−2.0	+1.0	−27.4 Feb	+2.6 Mar	+4.2	+2.0	10.3 Mar‡‡
Slovenia	−0.8 Q4	na	−1.5	+1.0	−22.3 Feb	+1.8 Mar	+6.9	+1.5	8.2 Feb‡‡
Ukraine	+6.9 Q3	na	−6.0	+2.0	−30.4 Mar	+18.1 Mar	+26.2	+16.6	3.2 Feb
Vietnam	+5.5 Q4	na	+1.6	+2.0	+2.4 Mar	+11.2 Mar	+19.4	+4.8	4.6 2007

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -0.4 in Mar. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Apr 30th 2009
From The Economist print edition

The Economist commodity-price index

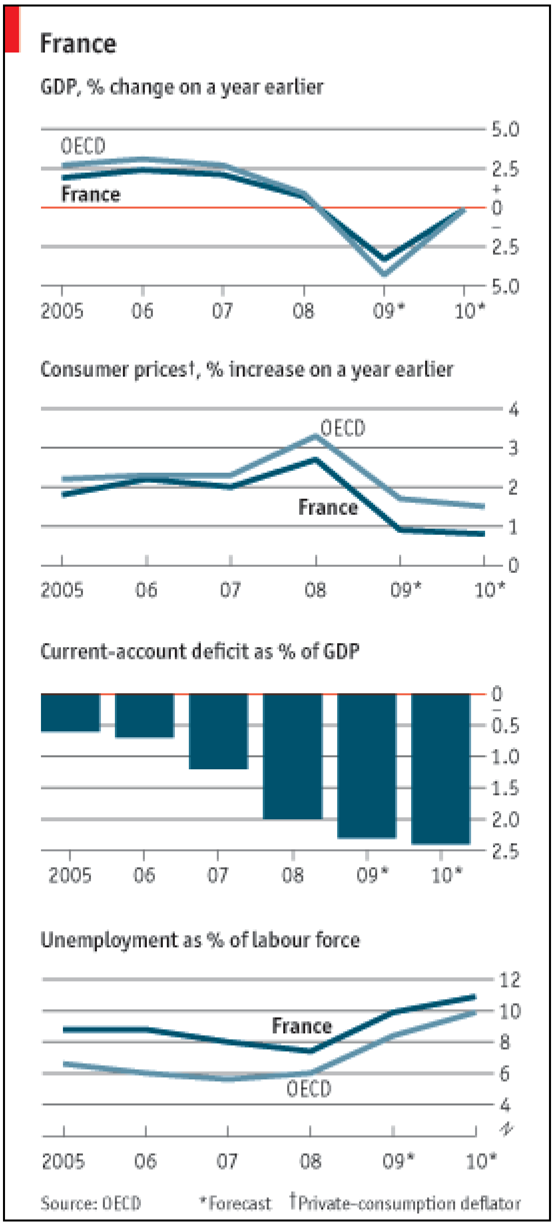
2000=100

	Apr 21st	Apr 28th*	% change on one month	% change on one year
Dollar index				
All items	166.9	164.9	+2.1	-36.1
Food	189.6	188.1	+0.6	-25.9
Industrials				
All	137.7	134.9	+4.9	-48.7
Nfa†	118.2	120.0	+6.4	-37.6
Metals	148.3	143.0	+4.2	-52.6
Sterling index				
All items	173.1	170.6	-0.2	-14.0
Euro index				
All items	119.1	116.6	+3.6	-23.7
Gold				
$ per oz	882.15	890.10	-2.8	+1.4
West Texas Intermediate				
$ per barrel	46.95	49.08	-0.6	-57.5

*Provisional †Non-food agriculturals.

France

Apr 30th 2009
From The Economist print edition



Trade, exchange rates, budget balances and interest rates

Apr 30th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance*	Current-account balance		Currency units, per $		Budget balance	Interest rates, %	
	latest 12 months, $bn	latest 12 months, $bn	% of GDP 2009†	Apr 29th	year ago	% of GDP 2009†	3-month latest	10-year gov't bonds, latest
United States	−761.0 Feb	−673.3 Q4	−3.3	-	-	−13.1	0.20	3.09
Japan	+21.0 Feb	+131.8 Feb	+1.5	97.0	105	−5.7	0.50	1.40
China	+316.9 Mar	+400.7 Q2	+6.2	6.83	6.99	−3.7	1.21	3.41
Britain	−163.1 Feb	−44.6 Q4	−1.7	0.68	0.50	−12.3	1.40	3.45
Canada	+37.1 Feb	+11.3 Q4	−2.0	1.20	1.01	−2.5	0.22	3.27
Euro area	−59.4 Feb	−150.9 Feb	−1.0	0.75	0.64	−5.7	1.37	3.13
Austria	−3.5 Jan	+16.8 Q3	+1.5	0.75	0.64	−4.6	1.37	3.93
Belgium	+8.2 Jan	−12.1 Dec	−1.4	0.75	0.64	−4.4	1.39	3.83
France	−79.9 Feb	−54.4 Feb	−2.2	0.75	0.64	−6.6	1.37	3.55
Germany	+234.6 Feb	+206.2 Feb	+4.5	0.75	0.64	−4.4	1.37	3.13
Greece	−63.2 Jan	−48.7 Feb	−12.8	0.75	0.64	−5.0	1.37	5.30
Italy	−15.7 Feb	−72.9 Feb	−2.6	0.75	0.64	−5.3	1.37	4.26
Netherlands	+50.2 Feb	+65.3 Q4	+5.9	0.75	0.64	−3.1	1.37	3.65
Spain	−127.3 Feb	−145.2 Jan	−7.5	0.75	0.64	−9.6	1.37	3.89
Czech Republic	+3.5 Feb	−7.2 Feb	−2.2	20.2	16.2	−3.6	2.51	5.43
Denmark	+6.0 Feb	+6.4 Feb	+1.0	5.61	4.79	−2.5	2.89	3.57
Hungary	−0.2 Feb	−13.0 Q4	−3.0	218	162	−2.9	9.69	10.81
Norway	+70.5 Mar	+83.4 Q4	+10.5	6.56	5.11	10.5	2.74	3.89
Poland	−22.2 Feb	−25.5 Feb	−5.1	3.33	2.22	−3.2	4.29	5.99
Russia	+159.3 Feb	+98.9 Q4	−1.1	33.2	23.7	−8.0	12.50	10.71
Sweden	+13.7 Mar	+40.3 Q4	+7.3	8.05	5.99	−4.7	0.25	3.15
Switzerland	+16.9 Mar	+53.3 Q4	+7.5	1.14	1.04	−2.0	0.40	2.00
Turkey	−60.8 Feb	−33.1 Feb	−1.3	1.60	1.28	−4.4	10.84	7.09‡
Australia	+2.2 Feb	−44.1 Q4	−5.2	1.38	1.06	−3.3	3.08	4.58
Hong Kong	−23.8 Mar	+30.6 Q4	+8.1	7.75	7.79	−4.0	0.79	1.97
India	−113.3 Feb	−37.5 Q4	−3.4	50.0	40.5	−7.3	3.35	7.43
Indonesia	+7.2 Feb	+0.6 Q4	−0.3	10,825	9,222	−2.9	8.78	8.56‡
Malaysia	+42.1 Feb	+39.1 Q4	+10.2	3.59	3.16	−8.7	2.09	3.23‡
Pakistan	−18.7 Mar	−15.3 Q4	−1.3	80.5	64.6	−6.4	13.23	17.78‡
Singapore	+16.3 Mar	+27.1 Q4	+17.2	1.48	1.36	−4.1	0.58	1.89
South Korea	−2.8 Mar	+7.4 Mar	+1.9	1,341	1,003	−6.5	2.41	4.50
Taiwan	+9.8 Mar	+25.0 Q4	+7.9	33.7	30.4	−5.0	0.85	1.46
Thailand	+7.8 Mar	+5.9 Mar	+2.0	35.4	31.7	−4.7	1.45	2.38
Argentina	+13.6 Mar	+7.6 Q4	+1.1	3.72	3.16	−0.8	14.44	na
Brazil	+25.0 Mar	−23.0 Mar	−1.2	2.18	1.69	−2.0	11.16	6.16‡
Chile	+4.6 Mar	−3.4 Q4	−3.8	589	460	−3.4	2.28	3.61‡
Colombia	+2.1 Feb	−6.8 Q4	−4.0	2,290	1,767	−3.3	6.87	6.25‡
Mexico	−17.2 Mar	−2.4 Q4	−3.5	13.7	10.5	−5.3	5.74	7.58
Venezuela	+39.2 Q4	+39.2 Q4	+0.4	6.70	3.40§	−5.3	16.03	6.55‡
Egypt	−26.8 Q4	−1.3 Q4	−0.8	5.64	5.38	−6.9	10.41	3.50‡
Israel	−12.0 Mar	+1.6 Q4	+2.0	4.20	3.43	−5.9	0.45	3.51
Saudi Arabia	+197.4 2008	+124.0 2008	−8.4	3.75	3.75	−9.0	0.93	na
South Africa	−8.0 Feb	−21.0 Q4	−5.5	8.53	7.55	−4.0	8.40	8.29
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−3.2 Feb	−1.8 Feb	−3.0	11.8	10.0	−3.5	6.37	na
Finland	+8.0 Feb	+3.4 Feb	+0.6	0.75	0.64	−4.1	1.38	3.70
Iceland	+0.2 Mar	−5.6 Q4	+0.4	127	74.9	−10.5	13.38	na
Ireland	+45.0 Feb	−12.7 Q4	−2.5	0.75	0.64	−12.0	1.37	5.17
Latvia	−5.2 Feb	−3.5 Feb	−4.0	0.53	0.45	−6.0	10.83	na
Lithuania	−6.1 Feb	−5.1 Feb	−4.0	2.60	2.22	−2.7	6.84	na
Luxembourg	−7.8 Jan	+3.0 Q4	na	0.75	0.64	−4.5	1.37	na
New Zealand	−3.3 Mar	−11.3 Q4	−6.7	1.74	1.28	−6.3	4.05	5.38
Peru	+2.2 Feb	−4.2 Q4	−5.9	3.02	2.85	−1.8	5.00	na
Philippines	−7.8 Feb	+4.2 Dec	+2.0	48.7	42.3	−2.7	4.06	na
Portugal	−33.8 Jan	−27.7 Feb	−9.7	0.75	0.64	−4.9	1.37	4.31
Slovakia	−1.2 Feb	−7.1 Feb	−6.2	22.7	20.7	−4.0	1.35	4.38
Slovenia	−4.3 Feb	−2.6 Jan	−3.5	0.75	0.64	−3.7	1.37	na
Ukraine	−16.9 Q4	−10.1 Q1	−2.2	8.08	4.85	−4.0	15.20	na
Vietnam	−8.2 Mar	−7.0 2007	−1.8	17,783	16,122	−8.2	8.00	8.05

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Apr 30th 2009
From The Economist print edition

Markets

	Index Apr 29th	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	8,185.7	+3.8	-6.7	-6.7
United States (S&P 500)	873.6	+3.6	-3.3	-3.3
United States (NAScomp)	1,711.9	+4.0	+8.6	+8.6
Japan (Nikkei 225)	8,493.8	-2.7	-4.1	-10.4
Japan (Topix)	812.0	-2.2	-5.5	-11.7
China (SSEA)	2,590.9	+0.3	+35.5	+35.5
China (SSEB, $ terms)	160.5	-0.7	+44.8	+44.7
Britain (FTSE 100)	4,189.6	+3.9	-5.5	-3.0
Canada (S&P TSX)	9,416.3	+1.5	+4.8	+7.6
Euro area (FTSE Euro 100)	720.4	+2.1	-3.5	-7.9
Euro area (DJ STOXX 50)	2,334.6	+2.1	-4.6	-9.0
Austria (ATX)	1,816.1	+0.5	+3.7	-1.0
Belgium (Bel 20)	1,951.0	+2.5	+2.2	-2.4
France (CAC 40)	3,116.9	+3.0	-3.1	-7.6
Germany (DAX)*	4,704.6	+2.4	-2.2	-6.6
Greece (Athex Comp)	1,990.5	+5.1	+11.4	+6.3
Italy (S&P/MIB)	18,904.0	+4.5	-2.9	-7.3
Netherlands (AEX)	238.1	+0.5	-3.2	-7.6
Spain (Madrid SE)	921.3	-0.2	-5.6	-9.9
Czech Republic (PX)	847.6	+3.1	-1.2	-5.4
Denmark (OMXCB)	247.0	+3.2	+9.2	+4.2
Hungary (BUX)	12,878.6	+3.3	+5.2	-7.7
Norway (OSEAX)	295.0	+4.2	+9.2	+16.5
Poland (WIG)	28,273.9	+3.1	+3.8	-7.5
Russia (RTS, $ terms)	814.8	+3.8	+40.1	+28.9
Sweden (OMXS30)†	768.8	+0.1	+16.1	+14.1
Switzerland (SMI)	5,152.7	+1.8	-6.9	-12.8
Turkey (ISE)	30,746.4	+6.2	+14.5	+10.7
Australia (All Ord.)	3,661.9	+1.0	+0.1	+2.7
Hong Kong (Hang Seng)	14,957.0	+0.5	+4.0	+4.0
India (BSE)	11,403.3	+5.4	+18.2	+15.1
Indonesia (JSX)	1,644.2	+1.8	+21.3	+22.1
Malaysia (KLSE)	967.5	-0.1	+10.3	+6.4
Pakistan (KSE)	7,271.3	-4.0	+24.0	+21.8
Singapore (STI)	1,849.6	+0.3	+5.0	+1.9
South Korea (KOSPI)	1,338.4	-1.3	+19.0	+11.8
Taiwan (TWI)	5,614.1	-4.6	+22.3	+19.2
Thailand (SET)	483.5	+5.0	+7.5	+5.7
Argentina (MERV)	1,270.6	+3.6	+17.7	+9.2
Brazil (BVSP)	47,226.0	+5.2	+25.8	+34.6
Chile (IGPA)	12,928.7	+1.4	+14.2	+23.5
Colombia (IGBC)	8,362.5	+3.9	+10.6	+8.6
Mexico (IPC)	22,079.3	+2.8	-1.3	nil
Venezuela (IBC)	44,361.6	-0.3	+26.4	+36.1
Egypt (Case 30)	5,086.8	+2.1	+10.7	+8.2
Israel (TA-100)	728.3	+4.0	+29.1	+16.1
Saudi Arabia (Tadawul)	5,625.2	+4.6	+17.1	+17.2
South Africa (JSE AS)	20,481.8	+3.5	-4.8	+3.2
Europe (FTSEurofirst 300)	816.4	+2.7	-1.9	-6.3
World, dev'd (MSCI)	886.0	+3.3	-3.7	-3.7
Emerging markets (MSCI)	645.6	+2.6	+13.8	+13.8
World, all (MSCI)	223.0	+3.2	-2.0	-2.0
World bonds (Citigroup)	775.3	+1.6	-4.3	-4.3
EMBI+ (JPMorgan)	419.7	+0.6	+7.2	+7.2
Hedge funds (HFRX)§	1,040.1	+0.2	+1.9	+1.9
Volatility, US (VIX)	36.1	38.1	40.0	(levels)
CDSs, Eur (iTRAXX)‡	172.7	-3.7	-14.5	-18.4
CDSs, N Am (CDX)‡	229.6	-7.9	-1.6	-1.6
Carbon trading (EU ETS) €	13.7	+1.0	-15.0	-18.9

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Apr 28th

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MARKETS & DATA

WEEKLY INDICATORS

Global recessions

Apr 30th 2009
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Before this year the world economy had been in recession on four occasions in the past half century, if recession is defined as a drop in output per person. An analysis in the IMF's latest *World Economic Outlook* shows that, when exchange-rates are measured using purchasing-power parity, world output dipped sufficiently to drag down average output per person in 1975, 1982 and 1991. But on virtually every measure, this year's downturn is much deeper than previous troughs. Global output per head is set to fall by 2.5% this year, compared with an average of 0.4% in the previous global recessions. Global trade is set to shrink by almost 12%. In previous global recessions trade merely stagnated.